

# Home Office Deduction in Need of Repair: Applying Mixed-Use Allocation Theory to Internal Revenue Code Section 280A(c)

BRENDA A. RAY\*

*This Note challenges Congress to repair the home office deduction. It argues that the most current law in the home office deduction area—Commissioner v. Solomon and the Taxpayer Relief Act of 1997—fails to correct the inequities in this area of tax law. The inequities result from the current all-or-nothing approach to the home office deduction. The current approach creates a situation where a taxpayer may have actually used the home office for business purposes, but is completely denied a home office deduction.*

*The Note proposes an “actual use” test which would allow a home office deduction for the expenses attributable to the actual hours the home is used in connection with the taxpayer’s business. The proposed actual use test will ensure a proper deduction for the actual business-related costs the taxpayer incurs in using his or her home to operate a business. This Note urges that such changes are needed in the home office deduction area to keep up with the changing times in America. The proposed actual use test will allow a home office deduction to all those desiring the convenience, flexibility, economical efficiency, and family time that working from home provides.*

## I. INTRODUCTION

Imagine you are a small business owner. You currently operate your business from a rented office, but you realize that a room in your home would be the perfect place to operate the business. Working from your home would be convenient,<sup>1</sup> affordable,<sup>2</sup> and would give you more time to spend with your

---

\* Associate, Shumaker, Loop & Kendrick, LLP, Toledo, Ohio; J.D., Ohio State University College of Law, 1998; Certified Public Accountant, State of Ohio. I would like to thank the following members of the *Ohio State Law Journal* whose helpful comments greatly improved the quality of this Note: Derek Diaz, Tracy Kozicki, and David Torborg. I would also like to thank Mark Hafner, J.D., for suggesting that I focus my Note on creating a home office deduction that best suits today’s American family. Most importantly, I would like to thank my family for their endless love and support.

<sup>1</sup> Working from home is very convenient. See Kathleen M. Maloney, *There’s No Place Like Home, Ohio Lawyers Find Success in Home Practices*, OHIO LAWYER, March/April 1998, at 12, 14 (working whenever you want or need to, even during the middle of the night); *id.* at 13 (enjoying an informal dress code); *id.* at 33 (combining home and work tasks); *id.* at 13 (eliminating commuting time); Winningham Becker & Co., *Taxpayer Relief Act of 1997 Home Office Deduction Legislation* (visited Mar. 13, 1998) <[http://www.wbac.com/Articles/home\\_office.htm](http://www.wbac.com/Articles/home_office.htm)> (referring to a recent television commercial that “depicts the woman just waking

family.<sup>3</sup> As a small business owner, you anticipate the home office deduction<sup>4</sup>

---

up in the morning in her pajamas, with uncombed hair and a cup of coffee simply turning her computer on, connecting the modem and 'going to work' (while dreading those face-to-face video conference calls)."). Many people are operating businesses from their homes today because they really enjoy working from home. *See Working at Home Works for Most*, DETROIT NEWS, Feb. 7, 1996, at J4 (reporting a survey of 1,005 home office workers indicating that 80% felt more productive working from home and liked the convenience of home-based work). This desire to work from home may be a result of "cocooning." *See* Shelby L. Murphy, *Home-Grown Success Stories*, AUSTIN BUS. J., June 21, 1996, available in 1996 WL 10030155 ("[B]ecause of the burgeoning technology and the growing range of personal and business services available, Americans will have less need to go out to do things—from shopping to getting an education to earning a living . . ."). A home office is also a convenient place to meet clients. *See id.* (explaining that because of busy schedules during the week, the home office is a convenient place to meet clients on weekends and evenings). Not only is the home office convenient for the business owner, it is also convenient for the client. *See id.* There is a growing acceptance of home businesses. Clients have busy schedules too and appreciate being able to meet at times convenient for them. Meeting at a home also eliminates other hassles for clients, such as finding and paying for parking. Also, clients are more comfortable meeting in the low-keyed atmosphere a home provides. *See id.* "Home offices also [are convenient] for the community. They reduce commuting, helping decrease traffic congestion, pollution, road deterioration and energy consumption. And by letting people remain in their homes during the day, home-based businesses can add life to daytime neighborhoods, helping deter crime." NASE, *Home Office Deduction* (visited Mar. 13, 1998) <<http://www.membership.com/NASE/advocacy/issues/homeoffice.htm>>.

<sup>2</sup> The home office is an economically efficient place from which to conduct business. *See infra* note 93 and accompanying text. Working from home saves the home office worker the overhead costs of renting an office and commuting costs. *See* Maloney, *supra* note 1, at 13.

Today's technology allows small business owners to work affordably from their homes. *See id.* (explaining that home practices are possible because of moderate costs and easy access to office equipment). "[A]dvancements made in computers, the hefty drop in price of communication tools like fax machines, pagers and cellular phones, and the accessibility of the Internet and e-mail" have made working from home a viable option. *See* Murphy, *supra* note 1.

The Internet has given individuals the technology to operate businesses affordably from their homes. *See* Ann Margaret Bittinger, Comment, *The Home Office Deduction: The Times Are Changing but the Tax Code Is Not*, 45 U. KAN. L. REV. 921, 943 (1997). By the year 2000, the number of American households with Internet access is expected to reach 36 million. *See 36 Million U.S. Households to be Online by 2000: Survey*, AGENCE FRANCE-PRESSE, Jan. 6, 1997, available in 1997 WL 2035745. Commercial transactions on the Internet were just under \$1 billion in 1996. *See* Amanda Lang, *Barriers to Commerce on the Internet Falling Fast*, THE FIN. POST, Jan. 9, 1997, available in 1997 WL 4084479. Commercial transactions are expected to double in 1997, reach \$200 billion by the year 2000, and potentially reach \$1 trillion by 2010. *See id.*

<sup>3</sup> The need for flexibility is the main reason for the growth in home-based businesses. *See* Murphy, *supra* note 1. Workers are in search of flexible work hours and workplaces mainly to accommodate family obligations. *See id.* In this day and age, it often takes two-income families to meet financial obligations. *See* Bittinger, *supra* note 2, at 943 (citing *Issues Affecting Home-*

operating much like other mixed-use<sup>5</sup> business deductions, such as the business use of your car. As you are well aware from keeping track of your business miles every year, you are allowed a business deduction only to the extent you *actually use* your car for business purposes.<sup>6</sup> You contact your accountant or lawyer who informs you that, unlike the business use of your car, a deduction for the business use of the home is much less certain. You could, in fact, *actually use* your home

---

*Based Business Owners: Hearing Before the Senate Comm. on Small Bus.*, 104th Cong. (1996) (testimony of Sen. Bond), available in 1996 WL 10162583). Working from home helps relieve the financial stresses dual-income parents face, while providing the opportunity to spend more time with family. See *id.*; *Management, Meeting the Needs of Dual-Career Couples*, DELOITTE & TOUCHE REV. (Deloitte & Touche, Wilton, Conn.), Mar. 30, 1998, at 1 ("Families with both spouses working (dual-career families) made up almost 43 percent of the total in 1996 . . .").

<sup>4</sup> Internal Revenue Code § 280A(c)(1) allows a home office deduction for the portion of the home:

- (1) . . . which is exclusively used on a regular basis
  - (A) as the principal place of business for any trade or business of the taxpayer,
  - (B) as a place of business which is used by patients, clients, or customers in meeting or dealing with the taxpayer in the normal course of his trade or business, or
  - (C) in the case of a separate structure which is not attached to the dwelling unit, in connection with the taxpayer's trade or business.
- In the case of an employee, the proceeding sentence shall apply only if the exclusive use referred to in the preceding sentence is for the convenience of his employer.

I.R.C. § 280A(c)(1) (1998).

"Common deductible home office expenses include real estate taxes, mortgage interest, utilities, rent and depreciation." Roth & Company, P.C., *Articles: The Elusive Home Office Deduction* (last modified Aug. 20, 1997) <<http://www.rothcpa.com/homeof.htm>>.

A home office deduction is claimed on an individual income tax return by using forms 2106 and 8829. An employee deducts the expenses attributable to the home office on form 2106, which carries through to Schedule A, Itemized Deductions, of form 1040 as unreimbursed employee business expenses. Unreimbursed employee business expenses are deductible only as miscellaneous itemized deductions, and the deduction is subject to the 2% floor. A self-employed individual claims the home office deduction using form 8829, which carries through to Schedule C, Profit or Loss from Sole Proprietorship, of form 1040.

<sup>5</sup> A mixed-use asset is an asset that is generally a personal asset under the Tax Code, but it is also used for business purposes. See David R. Burton & Dan R. Mastromarco, *Special Report: The National Sales Tax: Moving Beyond the Idea*, 71 TAX NOTES 1237, 1246 (1996). An example of a mixed-use asset is a car. See *infra* notes 161–64 and accompanying text. Cars are generally personal assets, but they can also be used for business purposes. To determine the amount of the business deduction, an allocation is made to divide the mixed-use of the car into its business and personal use components. See *Travel & Transportation Expenses—Deductions and Recordkeeping Requirements*, 519 Tax Mgmt. (BNA) A-90 (1995). The *actual use* of the car for business purposes may be deductible, see Treas. Reg. § 1.162-2(b)(1) (1960), while the remaining personal use is a nondeductible personal expense.

<sup>6</sup> See *infra* note 163 and accompanying text.

office for business purposes during the taxable year, yet be *completely denied* any deduction whatsoever on your tax return. Confused, you wonder why the home office deduction is so uncertain<sup>7</sup> and unfair as compared to other valid business deductions.<sup>8</sup>

This scenario<sup>9</sup> exemplifies the feeling many small business owners have today—that they are denied legitimate business tax deductions for the business use of the home.<sup>10</sup> Many small business owners run businesses<sup>11</sup> from their

---

<sup>7</sup> See discussion *infra* Part II.B.3 (explaining the importance of having certainty in tax law to allow for accurate tax planning). The certainty of the proposed “actual use” test, see discussion *infra* Part V, allows for accurate tax planning for the home office deduction throughout the year.

<sup>8</sup> See discussion *infra* Part IV.C.1, which proposes an actual use test for the home office deduction. The application of the proposed actual use test will operate much like the business use of the car. See discussion *infra* Part IV.B. The taxpayer receives a home office deduction for the *actual hours* the taxpayer uses the home in connection with the taxpayer’s business and no deduction for personal use. The proposed actual use test is simple, see discussion *infra* Part IV.C.1.c, and eliminates the inequities of the current approach to the home office deduction, see discussion *infra* Part V.

<sup>9</sup> This scenario is based on a similar scenario used by Ann Margaret Bittinger. See Bittinger, *supra* note 2, at 921. The Bittinger scenario has a different focus. Her scenario criticizes the “governmental policy” behind the home office deduction that “encourages people to rent office space, which decreases economic efficiency, rather than work from home, which saves money and is family friendly.” *Id.*

<sup>10</sup> See *Tax-Home Office Deduction: Hearing on H.R. 9 Before the House Comm. on Small Bus.*, 104th Cong. 78 (1995) (statement of Rep. Morella) (The current criteria to determine who qualifies for the home office deduction “unfairly restrict[s] legitimate business tax deductions for many small business owners.”).

<sup>11</sup> Small businesses run from the home are important to the American economy. “The growth in the number of home office workers in the last fifteen years has been phenomenal, making home offices a central feature of today’s American economy.” Bittinger, *supra* note 2, at 941 (citing *Home Office Deduction and Subchapter S Corporation Reform: Hearing Before the Subcomm. on Taxation and IRS Oversight of the Senate Comm. on Fin.*, 104th Cong. 1, 11 (1995) (statement of Dr. Judith Obermayer, Chairman, Board of Directors of the National Association for the Self-Employed)); see also Joan M. Harvath, Note, *Federal Tax Law—Home Office Deduction Narrowed: Commissioner v. Soliman*, 113 S. Ct. 701 (1993), 77 MARQ. L. REV. 179, 199 (1993) (recognizing the increasing importance of home offices in today’s business world).

The economic efficiency of working from the home is the reason that many new small businesses start from the home. See Bittinger, *supra* note 2, at 945. “In a world of computer networks, e-mail, faxes, and overnight delivery services, home offices can be highly efficient.” NASE, *supra* note 1. “In a very real sense, the ability to maintain a home office at a reasonable cost has served as a catalyst to encourage many entrepreneurs to create new business ventures that generate income for themselves and that have the potential to grow and create new jobs for the economy.” Bittinger, *supra* note 2, at 945. “[In fact] [m]any of America’s most important

homes today.<sup>12</sup> For these small business owners, the home office deduction is an attractive opportunity to convert personal expenses associated with the home<sup>13</sup> into business deductions.<sup>14</sup> However, because of the potential for taxpayer abuse,<sup>15</sup> the government has sought to limit the use of the home office deduction as much as possible.<sup>16</sup> In the process of ensuring limited use of the home office

---

businesses originate out of a . . . garage or basement or out of the home office.” *Tax-Home Office Deduction: Hearing on H.R. 9 Before the House Comm. on Small Bus.*, 104th Cong. 3, 4 (1995) (testimony of Rep. Wayne Allard). Because home offices are important to the economy, they should be encouraged. *See id.*

<sup>12</sup> *See* GERALD C. CELENTE, *TRENDS 2000: HOW TO PREPARE FOR & PROFIT FROM THE CHANGES OF THE 21ST CENTURY* 156–68 (1997) (noting that 25 million people currently work full-time from home-based businesses in the United States and that, by the year 2000, nearly 50 million people will work out of their homes); Bittinger, *supra* note 2, at 941 (citing Andrew Leckey, *Home Sweet Office*, CHI. TRIB., Feb. 9, 1995, at C7 (indicating the percentage of American households with a family member working full-time from home has grown from 20% to 27% in less than a decade)); Cheryl Russell, *How Many Home Workers?*, AM. DEMOGRAPHICS, May 1996, at 6 (quoting a press release issued by Pacific Bell Directory that refers to the growth as a “remarkable boom in home-based business”).

“Home-based businesses are important for America. They offer a way for families that need to supervise children or the elderly to generate income, a way for workers who have been laid off by large companies to start over from their homes, a way for people to win the struggle against welfare dependency.” NASE, *supra* note 1.

“The growth [in home office workers] has affected women substantially. More than half of the home-based business owners are women.” Bittinger, *supra* note 2, at 941 (citing *Issues Affecting Home-Based Business Owners: Hearing Before the Senate Comm. on Small Bus.*, 104th Cong. (1996) (testimony of Sen. Bond), available in 1996 WL 10162583). “More than 3.5 million women in [the United States] run a business out of their home, according to a 1995 study by the National Foundation for Women Business Owners. An estimated 40 percent to 50 percent of all woman-owned firms in [the United States] are based in homes and employ an estimated 14 million people.” *Id.* at 942 (citing Michele Weldon, *Plan Essential to Success of Home Business*, HOUS. CHRON., May 22, 1996, at 1).

<sup>13</sup> The general rule is that expenses incurred in connection with the personal residence are nondeductible personal expenses. *See* I.R.C. § 280A(a) (1998).

<sup>14</sup> In 1992, approximately 1.6 million taxpayers filed home office deductions for a total of approximately \$2.4 billion. *See* Elizabeth M. MacDonald, *How to Write Off a Home Office Under Today's Rule*, MONEY, Mar. 1993, at 16. In 1995 about 1.5 million claimed the home office deduction. *See* NASE, *supra* note 1.

<sup>15</sup> *See* H.R. REP. NO. 94-658, at 160 (1976), reprinted in 1976 U.S.C.C.A.N. 2897, 3053–54 (explaining that the enactment of § 280A as part of the Tax Reform Act of 1976 was to remedy taxpayer abuse of the home office deduction); Bittinger, *supra* note 2, at 926, 926 n.47 (explaining that the pre-section 280A “appropriate and helpful” standard used by the courts to determine whether home office expenses were deductible was criticized for permitting conversion of nondeductible, personal living expenses into deductible business expenses without a substantial incremental cost to the taxpayer).

<sup>16</sup> *See* S. REP. NO. 94-938, at 147–48 (1976), reprinted in 1976 U.S.C.C.A.N. 3439, 3580

deduction,<sup>17</sup> the government has created *inequities*—unfairness, inequality, and uncertainty—in this area of tax law.<sup>18</sup>

This Comment focuses on the inequities faced by taxpayers in claiming a home office deduction under Internal Revenue Code section 280A(c)(1)(A).<sup>19</sup> Section 280A(c)(1)(A) allows a home office deduction for expenses allocable to the portion of the home exclusively used on a regular basis as “the *principal place of business* for any trade or business of the taxpayer.”<sup>20</sup> The most current law for determining whether a home office qualifies as a “principal place of business” is: (1) *Commissioner v. Soliman*,<sup>21</sup> and (2) section 932 of the Taxpayer Relief Act of 1997 (TRA).<sup>22</sup> *Soliman* is the Supreme Court’s landmark decision determining whether a home office qualifies as the taxpayer’s “principal place of business.” In *Soliman*, the Court virtually eliminated the home office deduction for many taxpayers by interpreting the definition of “principal place of business” very narrowly.<sup>23</sup> The Court was so concerned with preventing taxpayer abuse of the home office deduction that the inequities resulting from the decision were overlooked. Consequently, the *Soliman* decision has been extensively criticized both for severely limiting the home office deduction<sup>24</sup> and for failing to address the inequities in this area of tax law.<sup>25</sup>

---

(noting that the purpose of enacting § 280A(c)(1) is to substantially curtail the home office deduction).

<sup>17</sup> A major deterrent to claiming the home office deduction is the almost certainty that it will land you an IRS audit of your tax return. Many tax advisers refer to form 8829, the form used to compute the taxpayer’s home office deduction, as the “audit-me” form. See OSCP, *Measuring Up to the Home Office Deduction* (visited Mar. 13, 1998) <<http://www.oscpa.com/pr/measurin.htm>> (advising that the valuable opportunity to save tax dollars by claiming a home office deduction should not be passed up as too risky).

<sup>18</sup> See discussion *infra* Parts II.B, III.C.

<sup>19</sup> I.R.C. § 280A(c)(1)(A) (1998).

<sup>20</sup> *Id.* (emphasis added).

<sup>21</sup> 506 U.S. 168 (1993). See discussion *infra* Part II.

<sup>22</sup> Taxpayer Relief Act of 1997, Pub. L. No. 105-34, § 932(a), 111 Stat. 788, 881 (codified as amended at I.R.C. § 280A(c)(1) (1998)). See discussion *infra* Part III.

<sup>23</sup> See, e.g., Robert T. Kelly, Jr., *Home Office Deductions Restricted by Supreme Court*, 50 TAX’N FOR ACCT. 196 (1993); Michael M. Megaard & Susan L. Megaard, *Supreme Court Narrows Home Office Deductions in Soliman*, 78 J. TAX’N 132 (1993); Robert J. Gerlack, Comment, *What Has the Supreme Court Done? The Home Office Deduction Is Virtually Eliminated After Soliman*, 41 CLEV. ST. L. REV. 789, 795–96 (1993); Harvath, *supra* note 11, at 180.

<sup>24</sup> See *supra* note 23.

<sup>25</sup> See, e.g., John E. Byrnes, Note, *Commissioner of Internal Revenue v. Soliman: A Decision Wrongly Decided on “Principal,”* 2 GEO. MASON INDEP. L. REV. 429, 429 (arguing that *Soliman* treats “similarly situated taxpayers” differently and leads to uncertainty); Gerlack,

The most recent Internal Revenue Code amendment to the home office deduction is TRA section 932.<sup>26</sup> TRA directly responds to the controversy surrounding the *Soliman* decision by expanding the definition of “principal place of business” to include taxpayers who manage their businesses from the home office.<sup>27</sup> The purpose of the amendment is to reverse the result of the *Soliman* decision.<sup>28</sup> Unfortunately, instead of correcting the existing inequities in the home office deduction area, the amendment actually creates additional inequities.<sup>29</sup>

As will be discussed below,<sup>30</sup> the approach to the home office deduction under current law fails to adequately address the inequities in this area of tax law. The problem is that the current approach to the home office deduction is an all-or-nothing approach.<sup>31</sup> Under the all-or-nothing approach, as long as the

---

*supra* note 23, at 789 (The *Soliman* decision results in “unequal impact among taxpayers solely for the purpose of judicial efficiency.”).

<sup>26</sup> Taxpayer Relief Act of 1997, § 932(a). This amendment made to I.R.C. § 280A(c)(1) is estimated to reduce budget receipts by \$119 million in 1999; \$244 million in 2000; \$253 million in 2001; \$263 million in 2002; \$274 million in 2003; \$285 million in 2004; \$295 million in 2005; \$306 million in 2006; and \$318 million in 2007. *See* JOINT COMMITTEE ON TAXATION, 105TH CONG., 1ST SESS., ESTIMATED BUDGET EFFECTS OF THE CONFERENCE AGREEMENT ON THE REVENUE PROVISION OF H.R. 2014, THE “TAXPAYER RELIEF ACT OF 1997” 3 (Joint Comm. Print 1997).

<sup>27</sup> The amendment adds the following flush language to § 280A(c)(1):

[T]he term “principal place of business” includes a place of business which is used by the taxpayer for the administrative or management activities of any trade or business of the taxpayer if there is no other fixed location of such trade or business where the taxpayer conducts substantial administrative or management activities of such trade or business.

I.R.C. § 280A(c)(1) (1998) (flush language).

<sup>28</sup> *See* Martin D. Ginsburg, Essay, *Taxing the Components of Income: A U.S. Perspective*, 86 GEO. L.J. 123, 129 n.41 (1997) (explaining that TRA reverses the result of the *Soliman* decision). The comparative analysis test, *see* discussion *infra* Part II.A.2, developed by the Supreme Court in *Soliman* continues to apply in situations where the taxpayer fails to qualify for the home office deduction under § 280A(c)(1) as amended by TRA. *See Determining Whether Home Office Is Principal Place of Business*, 16 Fed. Tax. Coordinator 2d (RIA) ¶ L-1310, at 34,056 (Sept. 18, 1997).

<sup>29</sup> *See* discussion *infra* Part III.C.

<sup>30</sup> *See* discussion *infra* Parts II, III.

<sup>31</sup> The current all-or-nothing approach was developed as a result of the congressional policy behind the enactment of § 280A as part of the Tax Reform Act of 1976. Congress intended to allow home office deductions only to taxpayers who incur substantial expenses in maintaining a home office. *See* S. REP. NO. 94-938, at 147 (1976), *reprinted in* 1976 U.S.C.A.N. 3580. Taxpayers who only incur minor incremental expenses should not be entitled to the deduction. *See id.* The report cited an example of abuse by a university professor

taxpayer meets the requirements of section 280A(c)(1), all of the expenses allocable to the portion of the taxpayer's home used as the home office are deductible.<sup>32</sup> However, if the taxpayer fails the requirements of section 280A(c)(1), the taxpayer is *completely denied* a home office deduction even if the home office is *actually used* in connection with the taxpayer's business during the year. It is this all-or-nothing approach that creates the inequities under current law.<sup>33</sup>

Because of the inequities of the current approach to the home office deduction, a new approach is necessary. The home is a personal asset.<sup>34</sup> But the new approach to the home office deduction<sup>35</sup> recognizes that if a business is run from the home, the home becomes a mixed-use asset.<sup>36</sup> Applying mixed-use allocation theory<sup>37</sup> would allow a home office deduction to the extent the taxpayer *actually uses* the home office in connection with the taxpayer's business. Like other areas of tax law that deal with mixed business and personal use,<sup>38</sup> an allocation between personal and business use of the home office would ensure a proper deduction for the *actual* business-related costs the taxpayer incurs in using his or her own home as an office. Such allocation creates a new approach to the home office deduction that is fair, equitable, and certain.<sup>39</sup>

---

who was provided with an office by his employer. The taxpayer used a den in his home for grading papers and other activities. Congress felt this taxpayer should not be entitled to a home office deduction because only minor incremental expenses were incurred in order to perform these business activities. *See id.* The result is that a taxpayer may be *completely denied* a home office deduction even though expenses were in fact incurred in connection with the business use of a home office.

<sup>32</sup> *See* I.R.C. § 280A(c)(1) (1998).

<sup>33</sup> *See* discussion *infra* Part IV.A.

<sup>34</sup> *See* I.R.C. § 280A(a).

<sup>35</sup> *See* discussion *infra* Part IV.B.

<sup>36</sup> *See supra* note 5 (defining a mixed-use asset).

<sup>37</sup> Mixed-use allocation theory applies when a taxpayer uses an asset both for business and personal purposes. Mixed-use of an asset requires an apportionment between the business and personal elements of such use. *See, e.g., Hobby, Home Business and Home Rental Losses*, 547 Tax Mgmt. (BNA) A-74 (1994) (explaining that mixed-use allocation is required when a taxpayer who rents a dwelling unit personally uses the unit during the year); *Travel & Transportation Expenses—Deductions and Recordkeeping Requirements*, *supra* note 5 (explaining that mixed-use allocation is required in the case of an automobile used both for business and for personal purposes); *see also* discussion *infra* Part IV.B (proposing the application of mixed-use allocation theory to the home office deduction).

<sup>38</sup> Two other areas of tax law use an actual use approach for allocating expenses between mixed business and personal use: (1) the rental of the home, and (2) the business use of a car. *See* discussion *infra* Part IV.B.

<sup>39</sup> Fairness, equality, and certainty are the goals behind the tax law. *See* WEST'S FEDERAL



The purpose of this Comment is to introduce this new approach to the home office deduction area and to propose a new home office deduction statute based upon the new approach. Parts II and III of this Comment discuss the current state of the law in the home office deduction area. Part II discusses the *Soliman* decision, while Part III discusses the TRA amendment to section 280A(c)(1). Part IV suggests a new approach to the home office deduction that applies mixed-use allocation theory. A new home office deduction statute that allows a home office deduction to the extent the home office is *actually used* in connection with the taxpayer's business is proposed. Part V concludes that the proposed "actual use" test fulfills the goals of fairness, equality, and certainty in the home office deduction area.

## II. CURRENT STATE OF THE HOME OFFICE DEDUCTION

### A. Commissioner v. Soliman

*Commissioner v. Soliman*<sup>40</sup> is the Supreme Court's landmark decision in the home office deduction area. In *Soliman*, the Court decided the appropriate standard for determining whether a home office qualifies as the taxpayer's "principal place of business" under section 280A(c)(1)(A).<sup>41</sup> Such guidance by the Court was necessary. Section 280A(c)(1)(A) allows a home office deduction for expenses allocable to the portion of the home exclusively used on a regular basis as "the *principal place of business* for any trade or business of the taxpayer."<sup>42</sup> However, when Congress adopted section 280A as part of the 1976 Tax Reform Act, the term "principal place of business" was not defined.<sup>43</sup> Subsequently, the lower courts developed different tests designed to determine the taxpayer's "principal place of business."<sup>44</sup> The Supreme Court granted

---

TAXATION: INDIVIDUAL INCOME TAXES 1994 ANNUAL EDITION 1-4 to 1-5 (William H. Hoffman, Jr., et al. eds., 1993) [hereinafter WEST'S FEDERAL TAXATION] (stating that the canons of taxation include *equality, convenience, certainty, and economy*); Gerlack, *supra* note 23, at 803 ("[T]he purpose behind the tax code is to provide efficient, equal and fair rules and guidelines for taxation . . .").

<sup>40</sup> 506 U.S. 168 (1993).

<sup>41</sup> See *id.* at 170.

<sup>42</sup> I.R.C. § 280A(c)(1)(A) (1998) (emphasis added).

<sup>43</sup> See Tax Reform Act of 1976, Pub. L. No. 94-455, § 601, 90 Stat. 1520, 1569-72 (codified at I.R.C. § 280A (1998)).

<sup>44</sup> Compare *Jackson v. Commissioner*, 76 T.C. 696 (1981) (adopting a "focal point" test that looked to the place where the taxpayer provides goods and services and generates revenues), and *Baie v. Commissioner*, 74 T.C. 105 (1980) (same), with *Pomerantz v. Commissioner*, 867 F.2d 495 (9th Cir. 1988) (criticizing the "focal point" test's narrow focus on the point of delivery and comparing the multiple business locations to determine which is

certiorari in *Soliman* to resolve the conflict in the lower courts.<sup>45</sup>

### 1. *Factual and Procedural Background*

Nader E. Soliman was a self-employed anesthesiologist who practiced thirty to thirty-five hours per week at three hospitals, none of which provided him office space.<sup>46</sup> Soliman used a room in his home exclusively to perform two to three hours per day of administrative and management activities for his medical practice.<sup>47</sup> Soliman claimed a home office deduction on his income tax return for the expenses associated with his home office.<sup>48</sup> The case was brought before the Tax Court after the Commissioner denied the deduction.<sup>49</sup> The Tax Court disagreed with the Commissioner and allowed the deduction.<sup>50</sup> The Fourth Circuit affirmed.<sup>51</sup> The Supreme Court reversed the appeals court and denied

---

the principal place of business), *Meiers v. Commissioner*, 782 F.2d 75 (7th Cir. 1986) (same), *Weissman v. Commissioner*, 751 F.2d 512 (2nd Cir. 1984) (same), and *Drucker v. Commissioner*, 715 F.2d 67 (2nd Cir. 1983) (same).

<sup>45</sup> See *Soliman*, 506 U.S. at 172.

<sup>46</sup> See *id.* at 168.

<sup>47</sup> See *id.* at 170. Soliman used one bedroom of his apartment as his home office. See *Soliman v. Commissioner*, 94 T.C. 20, 21–22 (1990), *aff'd*, 935 F.2d 52 (4th Cir. 1991), *rev'd*, 506 U.S. 168 (1993). In his home office, Soliman kept the following: chair, desk, couch, telephone, answering machine, copier, filing cabinet, patient records, billing records, correspondence with patients, names of surgeons and insurance companies, medical journals, medical texts, collection agency records, and insurance code books. See *id.* at 21. From his home office, Soliman contacted surgeons and patients by telephone, contacted hospitals to arrange admission for his own patients, maintained detailed billing records and patient logs, transmitted this information to a billing service, recorded collected payments on the patients logs, read medical books and journals, and prepared for specific patients. See *id.* at 21–22. Soliman also satisfied his continuing medical education requirements and prepared for his monthly presentations to post-anesthesia care nurses from his home office. See *id.* at 22.

<sup>48</sup> See *Soliman*, 506 U.S. at 168. For the taxable year 1983, Soliman deducted home office expenses and depreciation of \$841. See *Soliman*, 94 T.C. at 22. Soliman also deducted expenses relating to travel between the hospitals and his home office of about \$3,700 in 1983. See *id.*

<sup>49</sup> See *Soliman*, 506 U.S. at 168.

<sup>50</sup> See *Soliman*, 94 T.C. at 26–28 (finding Soliman's lack of any other office but the home office and the amount of time that Soliman spent at the home office to be important factors in allowing the home office deduction).

<sup>51</sup> See *Soliman v. Commissioner*, 935 F.2d 52, 54 (4th Cir. 1991) (adopting a facts and circumstances test, the court ruled that the home office is the "principal place of business" if: (1) the home office is essential to the taxpayer's business, (2) the taxpayer spent a substantial amount of time in the home office, and (3) there is no other location available to the taxpayer from which to perform office work).

Soliman the home office deduction.<sup>52</sup>

## 2. The Comparative Analysis Test

In reversing the court of appeals decision, the Supreme Court developed a comparative analysis test designed to determine the taxpayer's "principal place of business."<sup>53</sup> The premise of the comparative analysis test is that the taxpayer's "*principal* place of business"<sup>54</sup> is the business location that is "most important" to the taxpayer's business.<sup>55</sup> Determining whether a particular business location is the taxpayer's principal place of business requires comparing that location to all of the taxpayer's business locations.<sup>56</sup> If the home office is not the "most important" business location when compared to the taxpayer's other business locations, the home office is not the taxpayer's "principal place of business."<sup>57</sup> Consequently, the taxpayer is denied a home office deduction.

Under the comparative analysis test, two factors receive "primary consideration[ ] in deciding whether [the] home office is a taxpayer's principal place of business: [1] the relative importance of the activities performed at each business location[ ], and [2] the time spent at each [location]."<sup>58</sup> Although the test gives primary consideration to these two factors, the Court realized that the inquiry into determining the location of the "principal place of business" is "ultimate[ly] . . . dependent upon the particular facts of each case."<sup>59</sup>

The first prong of the comparative analysis test is to consider the relative importance of the activities performed by the taxpayer at each business

---

<sup>52</sup> See *Soliman*, 506 U.S. at 170.

<sup>53</sup> See *id.* at 175.

<sup>54</sup> I.R.C. § 280A(c)(1)(A) (1998) (emphasis added).

<sup>55</sup> See *Soliman*, 506 U.S. at 174.

<sup>56</sup> See *id.*

<sup>57</sup> See *id.*

<sup>58</sup> *Id.* at 175. However, the comparative analysis test may not always find a "principal place of business." The Court noted that:

The comparative analysis of business locations . . . may not result in every case in the specification of which location is the principal place of business; the only question that must be answered is whether the home office so qualifies. There may be cases when there is no principal place of business, and the courts and the Commissioner should not strain to conclude that a home office qualifies for the deduction simply because no other location seems to be the principal place. [In other words,] [t]he taxpayer's house does not become a principal place of business by default.

*Id.* at 177.

<sup>59</sup> *Id.* at 175.

location.<sup>60</sup> “[A]ny particular business is likely to have a pattern in which certain activities are of most significance.”<sup>61</sup> The Court is required to objectively evaluate the “particular characteristics of the specific business . . . at issue” to determine which “certain activities are of most significance.”<sup>62</sup> The business location where the most important activities<sup>63</sup> take place will be considered the taxpayer’s “principal place of business” under this prong of the comparative analysis test.<sup>64</sup>

“In addition to measuring the relative importance of the activities undertaken at each business location,” a comparison is made between “the amount of time spent at home [and] the time spent at other places where business activities occur.”<sup>65</sup> The second prong “assumes particular significance when comparison of the importance of the functions performed at various places yields no definitive answer to the principal place of business inquiry.”<sup>66</sup>

---

<sup>60</sup> *See id.*

<sup>61</sup> *Id.*

<sup>62</sup> *Id.* For example, “[i]f the nature of the trade or profession requires the taxpayer to meet or confer with a client or patient or to deliver goods or [render] services to a customer, the place where that contact occurs is often an important indicator of the principal place of business.” *Id.* Such points of contact are “given great weight in determining the place where the most important functions are performed.” *Id.* However, “no one test is determinative in every case.” *Id.*

<sup>63</sup> What is clear from the Court’s opinion is that administrative-type activities, while necessary to any business, are less important to the determination of the taxpayer’s “principal place of business” than are the delivering of goods or rendering of services. The Court notes:

[W]e do not regard the necessity of the functions performed at home as having much weight in determining entitlement to the deduction. In many instances, planning and initial preparation for performing a service or delivering goods are essential to the ultimate performance of the service or delivery of the goods, just as accounting and billing are often essential at the final stages of the process. But that is simply because, in integrated transactions, all steps are essential. Whether the functions performed in the home office are necessary to the business is relevant to the determination of whether a home office is the principal place of business in a particular case, but it is not controlling. Essentiality, then, is but part of the assessment of the relative importance of the functions performed at each of the competing locations.

*Id.* at 176–77.

<sup>64</sup> *See id.* at 175.

<sup>65</sup> *Id.* at 177.

<sup>66</sup> *Id.* For example, this factor becomes important when “a taxpayer performs income-generating tasks at both his home office and some other location.” *Id.*

### 3. *Application of the Comparative Analysis Test to the Facts of Soliman*

In *Soliman*, a comparative analysis was necessary because Soliman had more than one business location.<sup>67</sup> Soliman had four business locations: the three hospitals where he performed medical procedures,<sup>68</sup> and his home office.<sup>69</sup> In applying the comparative analysis test, the Court first looked objectively at the practice of anesthesiology to determine which activities are most significant to that particular medical practice.<sup>70</sup> For an anesthesiologist, the actual treatment of patients is “the essence of the professional service” and, therefore, “the most significant event in the professional transaction.”<sup>71</sup> The home office was used for planning and studying<sup>72</sup> in preparation for the performance of actual medical treatment. Actual treatment did not take place, however, in the home office.<sup>73</sup> The administrative activities performed at the home office, while essential to Soliman’s business,<sup>74</sup> are “less important to the business of the taxpayer than the tasks he performed at the hospital.”<sup>75</sup> Therefore, the most significant activities of Soliman’s practice occurred not at the home office, but at the hospitals where actual medical treatment took place.<sup>76</sup>

Next, the Court compared the amount of time spent by Soliman at the home office with the amount of time spent at the hospitals.<sup>77</sup> Soliman spent ten to fifteen hours per week in the home office and thirty to thirty-five hours per week at the three different hospitals.<sup>78</sup> The Court found that the time spent at the home office was “insufficient to render the home office the principal place of business in light of all the circumstances . . . .”<sup>79</sup> After applying the comparative analysis test, it was clear that the hospitals, and not the home office, were where the most significant activities took place and the most time was spent.<sup>80</sup> Therefore,

---

<sup>67</sup> *See id.*

<sup>68</sup> *See id.* at 168.

<sup>69</sup> *See id.* at 170.

<sup>70</sup> *See id.* at 178.

<sup>71</sup> *Id.*

<sup>72</sup> *See id.* at 170. The home office was used for bookkeeping, correspondence, reading medical journals, and communicating with surgeons, patients, and insurance companies.

<sup>73</sup> *See id.* at 178.

<sup>74</sup> *See id.* at 179.

<sup>75</sup> *Id.* at 178.

<sup>76</sup> *See id.*

<sup>77</sup> *See id.* at 178–79.

<sup>78</sup> *See id.*

<sup>79</sup> *Id.*

<sup>80</sup> *See id.*

because the home office was not the taxpayer's "principal place of business,"<sup>81</sup> the Court held that the taxpayer was not entitled to the home office deduction.<sup>82</sup>

## B. Soliman: *Unfairness, Inequalities, and Uncertainty Remains*

### 1. *Unfairness of Soliman: Unfairly Forces Office Rental*

Much of the criticism of the *Soliman* decision centered on its unfair result. Even though the Court defined the inquiry into the "principal place of business" as ultimately depending upon the "particular facts of each case,"<sup>83</sup> the Court promptly ignored the circumstances in which Soliman found himself. Because none of the hospitals where Soliman performed medical procedures provided him with office space,<sup>84</sup> Soliman performed one hundred percent of the administrative and management activities related to his business from his home office.<sup>85</sup> However, the Court rejected "reliance on the availability of alternative office space as an additional consideration in determining [the] taxpayer's principal place of business."<sup>86</sup>

The fact that Soliman did not have an alternative location available from which to manage his business should have made his use of the home office relatively more important.<sup>87</sup> However, the Court focused solely on the nature of

---

<sup>81</sup> *See id.* at 178.

<sup>82</sup> *See id.*

<sup>83</sup> *Id.* at 175.

<sup>84</sup> *See id.* at 168.

<sup>85</sup> *See id.* at 170.

<sup>86</sup> *Id.* at 177. The Court limited the consideration of the availability of alternative office space to an employee situation. The Court stated that while the availability of alternative office space is "relevant in deciding whether an employee taxpayer's use of a home office is 'for the convenience of his employer' as required in § 280A(c)(1), it has no bearing on the inquiry whether a home office is the principal place of business." *Id.*

However, the tests developed by the lower courts did consider that the availability of alternative office space was important to the determination of the taxpayer's principal place of business. For example, when the Fourth Circuit affirmed the Tax Court decision of *Soliman*, a facts and circumstances test was applied. *See Soliman v. Commissioner*, 935 F.2d 52, 55 (4th Cir. 1991). The court realized that a principal place of business was not necessarily where goods and services are transferred to clients or customers, but was often the administrative headquarters of a business. *See id.* The court considered further that where no other suitable office was provided for essential organization activities of a business, the fact that goods or services were delivered elsewhere did not, by itself, require a conclusion that a home office was not the principal place of business. *See id.* at 54. Applying the facts and circumstances test to Soliman's situation, the court allowed the home office deduction. *See id.* at 55.

<sup>87</sup> *See Harvath, supra* note 11, at 191-92. Harvath explains:

the activities performed from the home office, finding them "less important" to Soliman's business than the actual treatment of patients.<sup>88</sup> In doing so, the Court ignored Soliman's circumstances, which made it necessary to perform these activities from the home office.<sup>89</sup> Consequently, because of the current all-or-nothing approach, Soliman was *completely denied* the home office deduction even though the expenses incurred from the home office were bona fide business expenses.<sup>90</sup> Thus, the result of the decision was to unfairly deny a home office deduction to an individual who, out of the necessity of his circumstances, managed his business from his home office.

Furthermore, the result of the *Soliman* decision is that a taxpayer who rents space is entitled to the deduction<sup>91</sup> while someone who attempts to economize<sup>92</sup> by working from his or her home is not.<sup>93</sup> For example, if Soliman performed his administrative work from his home office, he would incur overhead expenses that he could not deduct. If, instead, Soliman rented office space to perform the same activities, he could deduct the expenses associated with the rented office under section 162.<sup>94</sup> Thus, the practical effect of the decision is to force the taxpayer to rent office space in order to obtain a deduction for expenses incurred in managing the business. It is inefficient to force Soliman to rent office space to obtain the deduction when those same activities could more conveniently be

---

[M]anagerial and administrative functions are the most important aspects of any business. No business can operate for very long if it is not well operated and managed. This is especially so in the case of a self-employed taxpayer like Dr. Soliman, who must have an office and who has no alternative office space.

*Id.*

<sup>88</sup> See *Soliman*, 506 U.S. at 178.

<sup>89</sup> See *id.* at 178-79. The Court also ignored the essential nature of these activities to the taxpayer's business.

<sup>90</sup> The proposed actual use test, see discussion *infra* Parts IV.C.1, eliminates this unfairness because the taxpayer is entitled to a home office deduction to the extent the home office is *actually used* in connection with the taxpayer's business.

<sup>91</sup> See Treas. Reg. § 1.162-6 (1960) (allowing a deduction for rent paid for office space).

<sup>92</sup> See *supra* note 1.

<sup>93</sup> See Rhonda M. Abrams, *Don't Give Up Home Office Deduction*, GANNETT NEWS SERVICE, May 20, 1993, available in 1993 WL 7312900 (criticizing *Soliman* by noting that a taxpayer who rents office space for a business can take the full deduction, but a home-based business is not accorded the same treatment); Harvath, *supra* note 11, at 195 (suggesting that *Soliman* discriminates in favor of the wealthy who can afford to rent office space outside the home); *Hatch Bill Would Clarify Home Office Deduction*, 66 TAX NOTES 1153 (1995) [hereinafter *Hatch Bill* article] (stating that *Soliman* grants a deduction for the rental of office space, but not for a home office).

<sup>94</sup> See I.R.C. § 162 (1998); Treas. Reg. § 1.162-6 (1960).

performed from the home office.

## 2. *Inequalities of Soliman: Unequal Impact on Different Professions*

The home office deduction should be available to any taxpayer who conducts a legitimate business from the home, regardless of the type of business conducted.<sup>95</sup> The home office deduction was not created with a specific profession in mind, nor does its language favor certain types of businesses over others.<sup>96</sup> Yet, the application of the *Soliman* decision results in an unequal impact among taxpayers in different types of businesses.<sup>97</sup> For example, under *Soliman*, home office deductions are *completely denied* for taxpayers such as house painters, carpenters, landscapers, construction workers, doctors, professors, musicians, artists, and sales professionals. Lawyers and accountants are unharmed, however, by the *Soliman* decision.<sup>98</sup> The *complete denial* of the home office deduction to some professions and not others is the result of the current all-or-nothing approach.<sup>99</sup>

To illustrate the unequal impact of the *Soliman* decision, compare the self-employed house painter to the self-employed accountant. Under *Soliman*, only the accountant has the potential to qualify for a home office deduction. For the house painter, the essence of his or her business is to paint homes. Under *Soliman*, the actual painting of homes would be most important to the house painter's business. Thus, the house painter's "principal place of business" is the location of the homes that he or she paints, not the home office. The painter's home office will never be a "principal place of business" as defined in *Soliman*. This is so because, obviously, the painter cannot paint homes from his or her home office. On the other hand, the essence of the accountant's business is to

---

<sup>95</sup> See Gerlack, *supra* note 23, at 806 (stating that the home office should not favor certain professions over others); Harvath, *supra* note 11, at 194, 194 n.126 ("The Supreme Court's decision will have the unintended effect of discriminating against certain types of businesspersons."); *id.* at 195 ("[N]o one type of business should be given grace over another. A business is a business; the inadvertent singling out of certain types of trades or professions for denial of the home office deduction will be an unfortunate result of the Court's decision in *Soliman*.").

<sup>96</sup> See Harvath, *supra* note 11, at 196 (stating that the home office deduction should be available to all taxpayers—including recently laid-off workers).

<sup>97</sup> See Gerlack, *supra* note 23, at 789 (discussing *Soliman*'s unequal impact among different professions); Harvath, *supra* note 11, at 180 (explaining that the *Soliman* decision is likely to lead to inconsistent results).

<sup>98</sup> See Gerlack, *supra* note 23, at 806.

<sup>99</sup> The proposed actual use test, *see* discussion *infra* Part IV.C.1, eliminates this inequality because the taxpayer, regardless of profession, is entitled to a home office deduction to the extent the home office is *actually used* in connection with the taxpayer's business.



prepare tax returns. The accountant can meet clients at the home office<sup>100</sup> and prepare tax returns from the home office. Thus, the accountant's "principal place of business" can potentially be the home office.

The Court's desire to prevent abuse of the home office deduction created inequalities among the professions. However, instead of addressing these inequalities, the Court in *Soliman* actually condones this result. The Court states that "[t]he requirements of particular trades or professions may preclude some taxpayers from using a home office as the principal place of business."<sup>101</sup> Essentially, the Court's decision in *Soliman* turned the home office deduction into a deduction exclusively for accountants and lawyers.<sup>102</sup>

### 3. Uncertainty Remaining After *Soliman*

Because income tax law is based on a pay-as-you-go tax system,<sup>103</sup> certainty in tax law is essential for tax planning.<sup>104</sup> In order to make accurate estimated income tax payments throughout the year, a taxpayer must be able to predict whether or not he or she will be entitled to a deduction. If a taxpayer, planning on receiving a deduction, makes estimated payments, but is *denied* the deduction at year end, then his or her taxes will be underpaid for the year and he or she may be subject to underpayment penalties.<sup>105</sup>

Instead of adding certainty to the home office deduction area, the *Soliman* decision creates uncertainty. The *Soliman* decision does not provide definitive rules for determining the availability of a home office deduction.<sup>106</sup> Each case

---

<sup>100</sup> The accountant that meets clients in the home office will qualify for the home office deduction under § 280A(c)(1)(B) because the home office is used "as a place of business which is used by . . . clients . . . in meeting or dealing with the taxpayer in the normal course of his trade or business . . ." I.R.C. § 280A(c)(1)(B) (1998).

<sup>101</sup> *Commissioner v. Soliman*, 506 U.S. 168, 177 (1993).

<sup>102</sup> See Gerlack, *supra* note 23, at 806.

<sup>103</sup> Pay-as-you-go procedures in an income tax system attempt to assure collection of taxes. See WEST'S FEDERAL TAXATION, *supra* note 39, at 1-12 to 1-13. A pay-as-you-go feature compels employers to withhold for income taxes a specified portion of an employee's wages. Persons with non-wage income, like self-employed individuals, must make quarterly payments to the Internal Revenue Service for estimated income taxes due for the year. See *id.* at 1-4.

<sup>104</sup> See *id.* at 1-4 (*certainty is a canon of taxation*).

<sup>105</sup> See I.R.C. § 6654 (1998).

<sup>106</sup> See *Soliman*, 506 U.S. at 184 (Thomas, J., concurring) ("We granted certiorari to clarify a recurring question of tax law that has been the subject of considerable disagreement. Unfortunately, this issue is no clearer today than it was before we granted certiorari."); *id.* at 193 (Stevens, J., dissenting) (arguing that the new comparative analysis test would "breed uncertainty in the law"); John S. Ross, III, *The Home Office Deduction After Soliman: Still No*

must still be judged on its own facts.<sup>107</sup> The taxpayer must wait until the end of the taxable year, after all the facts are gathered, to determine whether the taxpayer is entitled to a home office deduction. This creates uncertainty in tax planning for the home office deduction throughout the taxable year. And, because of the current all-or-nothing approach, the taxpayer may discover at year end that he or she fails to qualify for the home office deduction.<sup>108</sup>

---

*Bright Lines for Determining Principal Place of Business*, TAX MGMT. REAL EST. J., July 7, 1993, at 131 (arguing that the criteria in *Soliman* does not create a clear-cut method for arriving at a determination of whether a particular location actually constitutes a home office); Gerlack, *supra* note 23, at 806 ("The *Soliman* decision still does not afford clear guidelines for determining the availability of a home office deduction.").

The most uncertainty in the home office deduction area has centered on what constitutes a taxpayer's "principal place of business" under § 280A(c)(1)(A). See Glenn M. Fortin, Commissioner v. Soliman: *Supreme Court's Narrow Interpretation of "Principal Place of Business" Signals Need to Amend Home Office Deduction*, 27 GA. L. REV. 939, 942-43 (1993) (stating that the "principal place of business" interpretation is the subject of most controversy); Gerlack, *supra* note 23, at 795 (explaining that the "principal place of business" has produced the most litigation since the enactment of § 280A); Lyndon Sommer, Comment, *I.R.C. Section 280A: The Status of the Home Office Deduction—A Call to Congress to Get the House in Order*, 16 S. ILL. U. L.J. 501, 515 (1992) (noting that "[t]he vast majority of battles between taxpayers and the Commissioner in the home office deduction war have been fought over the principal place of business requirement"). Because the "principal place of business" exception has been so problematic, the proposed actual use test, see discussion *infra* Part IV.C, eliminates this element from the home office deduction.

<sup>107</sup> See *Soliman*, 506 U.S. at 177. Some of the factors that should be considered under the comparative analysis test of *Soliman* include:

- (1) the type of business conducted,
- (2) the important activities of the particular type of business conducted,
- (3) where the important activities are conducted,
- (4) the amount of time spent at each location,
- (5) the amount of time spent doing each type of activity involved, and
- (6) all the facts and circumstances surrounding the taxpayer's business.

See *Soliman*, 506 U.S. at 174-77; see also *Travel & Transportation Expenses—Deductions and Recordkeeping Requirements*, *supra* note 5, at A-84 (citing Rev. Rul. 94-24, 1994-15 I.R.B. 5, amplifying Notice 93-12, 1993-1 C.B. 298); INTERNAL REVENUE SERVICE, PUB. 587, BUSINESS USE OF YOUR HOME (1993).

<sup>108</sup> The proposed actual use test, see discussion *infra* Part IV.C.1, eliminates the uncertainty surrounding the home office deduction. The taxpayer can be certain that he will receive a home office deduction to the extent the taxpayer *actually uses* the home office in connection with the taxpayer's business.

### III. THE MOST RECENT CHANGE TO THE HOME OFFICE DEDUCTION: TAXPAYER RELIEF ACT OF 1997 AMENDS SECTION 280A(c)(1)(A)

#### A. Section 280A(c)(1) as Amended by TRA

The most recent change to the home office deduction is the amendment made to section 280A(c)(1) by the Taxpayer Relief Act of 1997 (TRA).<sup>109</sup> The history of the home office deduction is filled with lawmakers closing the door on the home office deduction.<sup>110</sup> However, the TRA amendment reverses this trend and opens the door to the home office deduction<sup>111</sup> by expanding the definition of “principal place of business” contained in section 280A(c)(1)(A).<sup>112</sup> Under section 280A(c)(1) as amended by TRA, a home office qualifies as a taxpayer’s “principal place of business” if the following two-part test is met:

[1] [the office] is used by the taxpayer for administrative or management activities of any trade or business of the taxpayer, [and] . . .

[2] there is no other fixed location of such trade or business where the taxpayer conducts substantial administrative or management activities of such business or trade.<sup>113</sup>

---

<sup>109</sup> Taxpayer Relief Act of 1997, Pub. L. No. 105-34, § 932(a), 111 Stat. 788, 881 (codified as amended at I.R.C. § 280A(c)(1) (1998) (flush language)).

<sup>110</sup> The purpose behind the enactment of § 280A in the Tax Reform Act of 1976 was to substantially curtail the home office deduction. *See* S. REP. NO. 94-938, at 144, 147 (1976); James Smith, ‘76 Act Locks the Door on Many Office-in-Home Deductions, 8 TAX ADVISER 354 (1977). Likewise, the *Soliman* decision limited the availability of the home office deduction. *See Soliman*, 506 U.S. at 173–74; *supra* note 23.

<sup>111</sup> TRA opens the door to the home office deduction because more taxpayers will be eligible for the home office deduction under the TRA amendment to § 280A(c)(1). *See* Arthur Andersen LLP, *The Taxpayer Relief Act of 1997*, 97 TAX NOTES TODAY 155-34, at Part II.A.5 ¶ 52 (Aug. 12, 1997), available in LEXIS, Fedtax Library, TNT File.

<sup>112</sup> President Clinton is pleased by the expansion of the home office deduction made by TRA. *See* President William J. Clinton, *President Clinton’s Statement on Signing Tax Bill*, 97 TAX NOTES TODAY 153-23, ¶ 17 (Aug. 8, 1997), available in LEXIS, Fedtax Library, TNT File. The President supported the expansion because it is intended to help “high-tech and biotech entrepreneurs, start-up companies, parents who work out of their homes, and other Americans who are seizing the opportunities of the new economy.” *Id.*

<sup>113</sup> I.R.C. § 280A(c)(1) (flush language). The expanded definition of a taxpayer’s principal place of business does not affect the requirement that home office expenses are deductible only if the office is used by the taxpayer exclusively on a regular basis as a place of business. Also, if the taxpayer is an employee, the taxpayer’s use of the home office must be for the convenience of the employer. And, the home office deduction may still only be claimed if there is a net income from the business activity. The amendment is effective for taxable years

For many taxpayers who manage their businesses from their home, the TRA does truly provide tangible relief<sup>114</sup> by relaxing the rules governing the home office deduction.<sup>115</sup> Such relief has been much sought after<sup>116</sup> following the

---

beginning after December 31, 1998. *See* H.R. REP. NO. 105-220, pt. IX, at 465 (1997).

<sup>114</sup> Although TRA does provide relief by making it easier for small business owners to claim the home office deduction, the home office deduction area needs not only relief, but true reform.

Americans not only need tax relief; they need tax reform. They need tax reform that really does simplify the Tax Code. They need reform that focuses on fairness. They need reform that maintains and promotes strong economic growth . . . . And they need reform that promotes American . . . competitiveness in the global economy.

143 CONG. REC. S8415, S8417 (daily ed. July 31, 1997) (statement of William V. Roth, Jr.). True reform of the home office deduction requires a new approach. *See* discussion *infra* Part IV.B. The proposed actual use test, *see* discussion *infra* Part IV.C.1, truly reforms the home office deduction. Unlike ever before, the proposed actual use test treats the home office deduction like other valid mixed-use business deductions. The test creates a home office deduction that is fair, equitable, certain, and simple. *See* discussion *infra* Part V.

<sup>115</sup> *See* Barton C. Massey, *Home Office Deduction Relaxed for Soliman-Type Taxpayers*, 97 TAX NOTES TODAY 163-3 (Aug. 22, 1997), available in LEXIS, Fedtax Library, TNT File. But, the extent of the relief may depend on the interaction of § 280A with § 121. Section 121 deals with the exclusion of gain on the sale of the personal residence. Section 121 as amended by TRA excludes up to \$250,000 (\$500,000 for married taxpayers filing jointly) of gain realized on the sale of a principal residence, *see* I.R.C. § 121(b)(2) (1998), while under old law only \$125,000 was excludable. Under new § 121, gross income does not include \$250,000 of gain "from the sale or exchange of property if, during the five year period ending on the date of sale or exchange, [the] property has been owned and used by the taxpayer as the taxpayer's principal residence for periods aggregating two years or more." *Id.* § 121(a). New § 121 is not a deferral of gain, like under § 1034, which was completely repealed by TRA, but rather is a permanent exclusion of gain. The new exclusion is not a one-time option as was old § 121. And, the new exclusion is available to all taxpayers, not just to those who reach age 55.

TRA considerably expanded both § 280A and § 121, making both more attractive. However, the home office deduction is less attractive because the taxpayer is required to recognize gain to the extent depreciation adjustments associated with the home office are taken. *See id.* § 121(d)(6). Section 121(d)(6) provides that the exclusion of gain realized on the sale of the principal residence "shall not apply to so much of the gain from the sale of any property as does not exceed the portion of the depreciation adjustment (as defined in section 1250(b)(3)) attributable to periods after May 6, 1997, in respect of such property." *Id.* As part of the home office deduction taken under § 280A(c)(1), depreciation on the portion of the residence used as a home office is an allowable deduction. "Therefore, when a portion of a principal residence is used as a home office after . . . [May 6, 1997], and depreciation adjustments are claimed, . . ." the taxpayer will be required to recapture this depreciation upon sale of the home. *See* Sheldon D. Pollack, *Highlight*, 59 TAX'N FOR ACCT. 188, 190 (1997) (Gain must be recognized on a subsequent sale of the home attributable to depreciation adjustments taken after May 6, 1997, "even if the space used as the home office is converted back to personal use before the

Supreme Court's controversial<sup>117</sup> *Soliman* decision. The amendment effectively overturns<sup>118</sup> the result<sup>119</sup> of the *Soliman* decision by relaxing the former section

---

residence is sold."); Philip P. Storrer, *Home Offices and the Section 121 Exclusion*, 97 TAX NOTES TODAY 211-77 (Nov. 17, 1997), available in LEXIS, Fedtax Library, TNT File (explaining that a way to obtain full exclusion upon sale of the home is to just not claim depreciation deductions associated with the home office).

Furthermore, the home office deduction becomes even less attractive if the allocations required by Treasury Regulation 1.1034-1(c)(3)(ii) for mixed use of the home are re-adopted. *See id.* (The allocations would need to be re-adopted because § 1034 and the regulations thereunder were completely repealed by TRA. At this point, it is uncertain but likely that the allocations will be re-adopted.). Under old law, a taxpayer was required to "recognize the portion of their realized gain which [was] attributable to the portion of their old house used as a home office." *Wigfall v. Commissioner*, 43 T.C.M. (CCH) 978, 980 (1982). The Court interpreted Treasury Regulation § 1.1034-1(c)(3)(ii), which required that where part of a property is used by the taxpayer as a principal residence and part is used for other purposes an allocation must be made to determine the application of § 1034. *See id.* If the old residence was used only partially for residential purposes, only the part of the gain allocable to the residential portion is not to be recognized under § 1034. *See id.*

If the mixed allocation regulation is re-adopted, the gain properly allocable to the portion of the home used as a home office would not be excludable under new § 121. For example, assume a taxpayer claims a home office deduction related to 10% of the home. In the event of a sale of the home, the gain properly allocable to the 10% use of the home as a home office would not be excludable under new § 121. *See Storrer, supra.* Therefore, the home office deduction as amended by TRA may not be as attractive as it seems. *See id.*

<sup>116</sup> William Kelliher, a partner with KPMG Peat Marwick's National Tax Office, Washington, says the home office deduction has always received a "huge amount of grassroots interest." Massey, *supra* note 115. Since the decision, both the House and Senate have introduced bills that would have overturned the *Soliman* decision. The bills were endorsed by trade associations. The "Contract with America" also contained a proposal responding to *Soliman*. Furthermore, the tax plan put forth in 1996 by unsuccessful presidential candidate Bob Dole contained a provision to restore the home office deduction to those who use the space for administrative and management purposes. Despite these numerous proposals, it has taken roughly four years for legislation to pass. *See id.*

<sup>117</sup> The *Soliman* decision prompted criticism and talk of relief through legislation. Shortly after the *Soliman* decision was announced, the AICPA labeled it "antibusiness" and claimed it would penalize those working out of their homes. *See Massey, supra* note 115. Gerald W. Padwe of the AICPA Tax Division said that *Soliman* put "a crimp" on legitimate claims for home office deductions. *See id.* During a 1995 House Small Business Committee hearing on the home office deduction, Debra Lessin, CPA, said the *Soliman* tests were shortsighted and ignored the way that business is conducted today: "Any perception that a taxpayer is merely trying to 'write off their dining room table' is outdated and misguided." *Id.* Lessin, joined by others present at the hearing, urged Congress to "correct the havoc created by the *Soliman* decision." *Id.*

<sup>118</sup> *See Taxes, Rules Clarified for Home Office Deduction*, DELOITTE & TOUCHE REV. (Deloitte & Touche, Wilton, Conn.), Sept. 29, 1997, at 5 (Section 932(a) of "the Taxpayer Relief Act of 1997 overrules [*Soliman*, the] Supreme Court decision that limited home office

280A requirements that generally disallowed the home office deduction unless the office was the taxpayer's primary business location. Under the amendment, a taxpayer who manages a business from the home office is entitled to the home office deduction.<sup>120</sup>

*B. The Amendment to Section 280A(c)(1) Addresses the Unfairness, Inequality, and Uncertainty of the Soliman Decision*

The amendment to section 280A(c)(1) addresses the unfairness,<sup>121</sup>

---

deductions."); *Hatch Bill* article, *supra* note 93, at 1153 ("This bill will clarify what a principal place of business is for purposes of section 280A . . . by] revers[ing] the Supreme Court's *Soliman* decision."); *Taxpayer Relief Act of 1997: Law and Explanation*, 84 Stand. Fed. Tax Rep. (CCH) Issue No. 42, No. 34, ¶ 109, at 143 (Aug. 13, 1997) ("With this provision, Congress effectively overturned the U.S. Supreme Court's decision in *N.E. Soliman* . . ."); *TRA '97 Revives Tax-Free Tuition, Raises Self-Employed Health Deductions, But Effects [sic] Few Other Benefit Changes*, 1997 WGL Employee Benefits Alert (RIA) 7 (Aug. 13, 1997) ("TRA reverses *Soliman* . . ."), available in LEXIS, TaxRIA Library, Benef. File. *But see Determining Whether Home Office Is Principal Place of Business*, 16 Fed. Tax. Coordinator 2d (RIA) ¶ L-1310, at 34,056.

[T]he enactment of this rule doesn't fully "repeal" the Supreme Court's decision in *Soliman*. It doesn't otherwise displace *Soliman*'s two-part test for determining whether a home office is a principal place of business . . . , and it doesn't resurrect either the "facts and circumstances" test or the "focal point" test that were in use before *Soliman*.

*Id.*

<sup>119</sup> The application of revised § 280A(c)(1) to the facts of *Soliman* demonstrates that the amendment does overturn the result of the decision. The first prong of the test is that the office in the home must be used by the taxpayer to conduct administrative or management activities of the taxpayer's trade or business. *See* I.R.C. § 280A(c)(1) (1998). Because *Soliman* spent two to three hours per day performing administrative or management activities related to his medical practice in his home office, *see* *Commissioner v. Soliman*, 506 U.S. 168, 170 (1993), the first prong is met.

The second prong of the test is that there is no other fixed location of the trade or business where the taxpayer conducts substantial administrative or management activities of the trade or business. *See* I.R.C. § 280A(c)(1). None of the hospitals where *Soliman* performed medical procedures provided him with an office. *See Soliman*, 506 U.S. at 170. *Soliman* performed 100% of his administrative activities from his home office. *See id.* Because *Soliman* did not, in fact, conduct substantial administrative or management activities at another fixed location other than his home office, the second prong is met. Therefore, *Soliman* would be allowed a home office deduction under the TRA amendment to section 280A(c)(1).

<sup>120</sup> *See* I.R.C. § 280A(c)(1).

<sup>121</sup> *See supra* Part II.B.1.

inequality,<sup>122</sup> and uncertainty<sup>123</sup> of the *Soliman* decision. Under the amendment, the taxpayer who manages a business from his or her home office is entitled to the home office deduction. The taxpayer is not forced, as under *Soliman*, to rent an office in order to deduct costs associated with the management of the business. As long as the taxpayer manages the business from the home office, the home office deduction is available. Also, any taxpayer who manages a business from his or her home office is entitled to the home office deduction, regardless of the type of business conducted. The home office deduction is no longer limited to the accounting and legal professions. Finally, the amendment does provide a level of certainty. As long as the taxpayer manages the business from the home office, the taxpayer is entitled to the home office deduction.

### C. Amendment to Section 280A(c)(1): Unfairness, Inequality, and Uncertainty Remains

Instead of analyzing the home office deduction to determine what should be done in this area,<sup>124</sup> Congress merely focused on correcting the result of the *Soliman* decision. Even though the unfairness, inequality, and uncertainty associated with the *Soliman* decision were addressed and corrected by the amendment,<sup>125</sup> the amendment itself creates additional unfairness, inequality, and uncertainty.

#### 1. Unfairness of TRA

##### a. TRA Unfairly Rewards Inefficiency

Although the amendment made to section 280A(c)(1) by TRA does open the door for many taxpayers to take home office deductions,<sup>126</sup> the amendment also opens the door to taxpayer inefficiency. For example, the committee report to TRA states that the following taxpayers are not prevented from taking a home office deduction under the new definition:

[T]axpayer[s] [who] in fact do[] not perform substantial administrative or management activities at any fixed location of the business away from

---

<sup>122</sup> See *supra* Part II.B.2.

<sup>123</sup> See *supra* Part II.B.3.

<sup>124</sup> The purpose of this Comment is to analyze what should be done in the home office deduction area. See discussion *infra* Part IV.

<sup>125</sup> See discussion *supra* Part III.B.

<sup>126</sup> Congress felt that the amendment to § 280A(c)(1) was an appropriate response to the growing number of taxpayers who manage their business activities from their homes.

home, . . . regardless of whether or not the taxpayer opted not to use an office away from home that was available for the conduct of such activities.<sup>127</sup>

According to this example, the taxpayer will not lose the deduction, even if the taxpayer has another office available, as long as the taxpayer does not actually use that office to perform substantial administrative or management activities. This may create inefficient work habits. For example, a self-employed lawyer may have a rented office and a home office. The amendment creates an incentive to complete administrative and management work at home, merely for the purpose of taking the home office deduction, rather than completing the work at the rented office. It may be that the most efficient place to complete administrative or management work is from the rented office, but the incentive now is to take this work home.<sup>128</sup> The current all-or-nothing approach strengthens this incentive. Under the current all-or-nothing approach, taxpayers are aware that if they fail the requirements of section 280A(c)(1), they will be *completely denied* the home office deduction.<sup>129</sup> The taxpayers may engage in inefficient work habits just to ensure the home office deduction. Therefore, the amendment may in fact unfairly reward the inefficient worker.

#### b. TRA Unfairly Rewards De Minimis Use of Home Office

Because the amendment does not contain a de minimis use requirement,<sup>130</sup>

---

<sup>127</sup> H.R. REP. NO. 105-220, pt. IX, at 464-65 (1997).

<sup>128</sup> Congress felt that *Soliman* unfairly denied the home office deduction to the growing number of taxpayers who manage their businesses from their homes. The computer and information revolution has made it more practical for taxpayers to manage business activities from a home office. The expansion of the home office deduction enables "more taxpayers to work efficiently at home, save commuting time and expenses, and spend additional time with their families." See JOINT COMMITTEE ON TAXATION, 105TH CONG., 1ST SESS., GENERAL EXPLANATION OF TAX LEGISLATION ENACTED IN 1997, pt.2, at 129 (Joint Comm. Print 1997) [hereinafter GENERAL EXPLANATION OF TAX LEGISLATION], reprinted in 97 TAX NOTES TODAY 245-72 (Dec. 22, 1997), available in LEXIS, Fedtax Library, TNT File. But, the amendment goes too far. In *Soliman*, Soliman did not have another office available, other than the home office, to manage his business. See *Commissioner v. Soliman*, 506 U.S. 168, 170 (1993). He worked from the home office out of necessity. The amendment reaches, however, beyond Soliman's situation and allows a home office deduction even if there is another office available. See *supra* note 127 and accompanying text.

<sup>129</sup> Under the proposed actual use test, see discussion *infra* Part IV.C.1, this incentive to work from home is less intensive. The taxpayer is ensured a home office deduction for the *actual use* of the home office in connection with the taxpayer's business. The taxpayer does not have to be concerned with a *complete denial* of the deduction.

<sup>130</sup> See generally Wendy C. Gerzog, *Expanding the Home Office Deduction: Impose at Least Two Safeguards*, 69 TAX NOTES 481 (1995) (arguing that a minimal use requirement is a



an individual who spends mere minutes in the home office could receive a home office deduction, while an individual who spends a considerable amount of time in the home office may be *completely denied* the deduction. For example, consider an individual whose business has a very small administrative component and who only works a few minutes each day in the home office.<sup>131</sup> If those few minutes constitute one hundred percent of the taxpayer's management activities, the taxpayer meets the definition of "principal place of business" under section 280A(c)(1) as amended by TRA.<sup>132</sup> Yet, an individual who spends considerably more time in his or her home office may still fail to qualify for the deduction. For example, such individual may be *completely denied* the deduction<sup>133</sup> if he or she performs "substantial administrative or management activities" outside the home office.<sup>134</sup> Therefore, the amendment unfairly rewards de minimis work performed from the home office.

## 2. Inequality of TRA: Self-Employed and Employee Treated Unequally

Under revised section 280A, self-employed individuals and employees are treated unequally. This is true even if the individuals are working in the same profession. To illustrate the unequal treatment of revised section 280A, compare the self-employed doctor to a doctor who is an employee of a hospital. Assume that each doctor has two offices available to perform administrative and management activities. One office is the home office, and the other office is a hospital-provided office.

Under revised section 280A, the self-employed doctor can potentially claim a home office deduction even if another office outside the home is available for the conduct of administrative or management activities associated with the

---

necessary safeguard to the home office deduction).

A de minimis use requirement is consistent with other mixed personal/business uses of the home. For example, the rental of all or a part of the home is subject to a de minimis rental rule. *See* I.R.C. § 280A(g) (1998). Under the de minimis rule, a taxpayer who rents a home for less than 15 days must exclude any income earned from such de minimis rental and may not deduct any expenses attributable to such rental. *See id.*; Prop. Treas. Reg. § 1.280A-3(b), 45 Fed. Reg. 52399 (1980).

<sup>131</sup> *See* Gerzog, *supra* note 130, at 481.

<sup>132</sup> *See id.*

<sup>133</sup> The *complete denial* of the home office deduction is the result of the current all-or-nothing approach. Under the proposed actual use test, *see* discussion *infra* Part IV.C.1, the taxpayer receives a home office deduction only to the extent of the *actual hours* of use of the home office in connection with the taxpayer's business. The proposed actual use test, therefore, eliminates concern for de minimis use of the home office.

<sup>134</sup> *See* I.R.C. § 280A(c)(1).

doctor's medical practice.<sup>135</sup> The self-employed doctor's home office will be his or her "principal place of business" under revised section 280A as long as the doctor, in fact, does not perform substantial administrative or management activities from the hospital-provided office. Thus, the self-employed doctor is potentially allowed a home office deduction even if the doctor opts not to use the hospital-provided office made available for the conduct of such activities, but instead chooses to use his or her home office.

In contrast, the employee-doctor who chooses not to use the employer-provided office is not entitled to the home office deduction. Section 280A allows an employee to take a home office deduction only if the use of the home office is "for the convenience of the employer."<sup>136</sup> An employee who maintains a home

---

<sup>135</sup> See *supra* note 119 and accompanying text.

<sup>136</sup> I.R.C. § 280A(c)(1) (flush language). The term "convenience of the employer" as used in § 280A(c)(1) is not defined in the Tax Code or Regulations. The term "convenience of the employer" limits the deduction of § 162 expenses attributable to the use of a dwelling unit in connection with the performance of services of an employee. The term is intended to indicate that if the use of the home office is merely appropriate and helpful to the *employee*, no deduction attributable to such use is allowed. See S. REP. NO. 94-938, at 148 (1976) (rejecting "appropriate and helpful" standard developed by the courts prior to the enactment of section 280A(c)(1) as part of the Tax Reform Act of 1976); H.R. REP. NO. 94-658, at 160-61 (1975) (same).

The burden of proof is on the taxpayer to show that the offer is "for the convenience of the employer." See *Drucker v. Commissioner*, 715 F.2d 67, 69 (2d Cir. 1983). The Tax Court and the IRS have taken different views as to what "for the convenience of the employer" requires the taxpayer to prove. See, e.g., *Bodzin v. Commissioner*, 60 T.C. 820, 825 (1973). *Bodzin* rejected the IRS's position in Rev. Rul. 62-180, 1962-2 C.B. 52, which stated that an employee is allowed a home office deduction only if his employer required the employee to maintain a home office as a condition of employment and if the office was regularly used for the performance of the employee's duties. See also *Kirby v. Commissioner*, 40 T.C.M. (CCH) 431 (1980) (allowing home office deduction for teachers who were ordered to leave unsafe schools after classes); *Newi v. Commissioner*, 28 T.C.M. (CCH) 686, 690-91 (1969), *aff'd*, 432 F.2d 998 (2d Cir. 1970) (granting a home office deduction even though the taxpayer's employer provided an office that was accessible during the evening hours).

Other relevant factors to consider in determining whether an employee has met the "convenience of the employer" test include:

- (1) the availability of the employer's facilities, (2) the employer's requirements and expectations, (3) the presence or absence of employer facilities for meeting clients or customers, (4) the suitability of the employer facility for the business activity, and (5) the location of the employer facility in a high-crime area or other area of limited accessibility.

Michael B. Lang, *When a House is not Entirely a Home: Deductions Under Internal Revenue Code § 280A for Home Offices, Vacation Homes, Etc.*, 1981 UTAH L. REV. 275, 291-92 (citing generally Filmore E. Rose, *Home Office Deductions Under the Tax Reform Act of 1976*, 63

office primarily for personal convenience is *denied* a home office deduction.<sup>137</sup> Therefore, in this illustration, the employee would be *denied* the home office deduction because the employee has an employer-provided office available for use. The use of the home office by the employee would not be considered “for the convenience of the employer,” but for the convenience of the *employee*.

The illustration indicates that revised section 280A treats similarly situated individuals differently. Both individuals are doctors, both have access to a hospital-provided office, and both have a home office available. The only difference between the two doctors is that one is self-employed and one is an employee. If both doctors chose to perform one hundred percent of their administrative and management work from the hospital-provided office, neither would be entitled to any type of deduction under any provision of the Tax Code because neither incurs any out-of-pocket expenses. In both cases, the hospital incurs the overhead expenses, and it is the hospital that deducts those expenses. However, if both individuals chose to perform one hundred percent of their administrative and management work from their home office, only the self-employed doctor has the potential for claiming a home office deduction, while the employee does not. The *complete denial* of the home office deduction to the employee, while allowing the self-employed a deduction, is a result of the current all-or-nothing approach to the home office deduction.<sup>138</sup>

---

A.B.A. J. 559, 561 (1977); Neil M. Goff, Comment, *Commingle Business and Personal Use of Real Property: Severe Restrictions Under the 1976 Tax Reform Act*, 13 GONZ. L. REV. 493, 510-12 (1978)).

<sup>137</sup> See *Bodzin v. Commissioner*, 509 F.2d 679 (4th Cir. 1973) (denying home office deduction to an IRS attorney-employee who worked in his home study despite availability of his government office because such use was partially for personal convenience of the employee); *Lucke v. Commissioner*, 48 T.C.M. (Prentice Hall) ¶ 79,453, at 79-1778 (1979) (finding that an accountant's use of home office to read tax journals was not tantamount to employer-required home office, but merely reflected personal preference and convenience); *Roberts v. Commissioner*, 48 T.C.M. (Prentice Hall) ¶ 79,250, at 79-962 (1979) (finding a professor who used apartment to study, research, and write did so as a matter of personal preference); *Coleman v. Commissioner*, 48 T.C.M. (Prentice Hall) ¶ 79,139, at 79-580 to 79-581 (1979) (finding occasional use of card table for typing was more for personal convenience and comfort than for business use).

Yet, as the illustration in the accompanying text shows, revised § 280A(c)(1) gives the self-employed individual an option. The self-employed individual can choose to perform administrative or management activities at the home office purely as a matter of personal convenience and even if there is another office available from which the same activities could be performed. However, this option is denied to a similarly situated employee.

<sup>138</sup> The proposed actual use test, *see infra* Part IV.C.1, eliminates this inequality. Under the proposed actual use test, both taxpayers, whether self-employed or an employee, are entitled to the home office deduction to the extent the home office is *actually used* in connection with the taxpayer's business.

It is unfair to allow the self-employed individual, as a matter of personal convenience, to have a choice of location from which to perform administrative or management activities while the employee is denied such a choice.<sup>139</sup> The employee, like the self-employed individual, may desire to perform administrative work from the home office as a matter of convenience, or to enjoy more family time. This is especially true today where the trend by many employers is to work fewer employees harder. As a result, many employees work very long hours. This means that less and less time is spent with family. To reduce the number of hours spent at work, many employees already take both non-administrative and administrative work home. This gives employees an opportunity to be with family earlier in the work day, which is important with so many two income families today. These quality of life issues are as important to the employee as they are to the self-employed individual. Therefore, the option of working from the home office purely as a matter of convenience should be equally available to both taxpayers.<sup>140</sup>

---

<sup>139</sup> See Fortin, *supra* note 106, at 968–69 (arguing that it is preferable not to explicitly distinguish between taxpayers on the basis of whether they are employees or self-employed because it is illogical and unfair). But see Harvath, *supra* note 11, at 196 n.137 (explaining that the concern about abuse and converting otherwise personal expenses is less of a concern with the self-employed, who must use their own home as their business headquarters).

<sup>140</sup> However, the self-employed doctor will most likely need the convenience of a home office more than a doctor who is an employee of one hospital because the nature of their practices are probably much different. In reality, the self-employed doctor most likely will perform medical procedures at many different hospitals. For example, the self-employed anesthesiologist involved in the *Soliman* case treated patients at three different hospitals in the Maryland and Virginia area. See *Commissioner v. Soliman*, 505 U.S. 168, 170 (1993). The travel associated with the self-employed doctor's medical practice can be very burdensome. To force the doctor to travel to the different hospitals just to perform administrative work is unrealistic and very inconvenient. This is especially true with a multi-state practice. Also, because the doctor must coordinate his practice at three different hospitals, a central location to manage his entire medical practice, such as the home office, would be very convenient. Consequently, there are valid business reasons why the self-employed individual needs the convenience of a home office.

On the other hand, the doctor who is an employee of a hospital will most likely work in one location. For the employee, working at home is, most likely, purely a matter of personal convenience—preferring to be physically at home versus at work. This is not true, however, for every profession or for every individual situation.

These differences in individual circumstances should not matter. With similarly situated taxpayers, if one is encouraged to use a home office purely as a matter of convenience, the other should have the same opportunity. Therefore, both should be given an equal opportunity to claim a home office deduction.

The Internal Revenue Code has, however, consistently treated employees differently from self-employed individuals. For example, employees must treat unreimbursed employee business expenses as miscellaneous itemized deductions, while the self-employed individual

### 3. Uncertainty of TRA: What Are Substantial Administrative or Management Activities?

Under section 280A(c)(1) as amended by TRA, a home office qualifies as a taxpayer's "principal place of business" if the following two-part test is met:

[1] the office is used by the taxpayer to conduct administrative or management activities of the taxpayer's trade or business, and

[2] there is no other fixed location of the trade or business where the taxpayer conducts *substantial administrative or management activities* of the trade or business.<sup>141</sup>

Although the amendment does provide a clear-cut answer if the taxpayer performs all of the administrative and management activities from the home office,<sup>142</sup> the result is uncertain if the taxpayer performs administrative or management activities both at the home office and at another location.<sup>143</sup> Much

---

claims these deductions on Schedule C. Also, employees have the additional burden of showing that expenses are for the "convenience of the employer" before they are entitled to certain business deductions. See I.R.C. § 280A(c)(1) (1998) (home office expenses must be for the convenience of the employer); *Id.* § 119 (meals or lodging furnished to an employee must be for the employer's convenience).

<sup>141</sup> I.R.C. § 280A(c)(1) (flush language) (emphasis added).

<sup>142</sup> If 100% of the administrative and management activities of the taxpayer's business are performed from the home office, then the taxpayer meets the § 280A(c)(1)(A) definition of "principal place of business." See *supra* note 119.

<sup>143</sup> However, the House Committee Report does provide some guidance by stating that taxpayers who perform administrative or management activities for their trade or business at places other than the home office are not automatically prohibited from taking the deduction. The House Committee Report clarifies that the following taxpayers are not prevented from taking a home office deduction under the new definition:

1. Taxpayers who do not conduct substantial administrative or management activities at a fixed location other than the home office, even if administrative or management activities (e.g., billing activities) are performed by other people at other locations;
2. Taxpayers who carry out administrative and management activities at sites that are not fixed locations of the business (e.g., cars or hotel rooms) in addition to performing the activities at the home office;
3. Taxpayers who conduct an insubstantial amount of administrative and management activities at a fixed location other than the home office (e.g., occasionally doing minimal paperwork at another fixed location);
4. Taxpayers who conduct substantial nonadministrative and nonmanagement business activities at a fixed location other than the home office (e.g., meeting with, or providing services to customers, clients, or patients at a fixed location other than the home office); and
5. Taxpayers who, in fact, do not perform substantial administrative or management

of the uncertainty centers around the interpretation of the word "substantial."<sup>144</sup> The word "substantial" is not defined in the Tax Code or regulations.<sup>145</sup> If the

---

activities at any fixed location of the business away from home, regardless of whether or not the taxpayer opted not to use an office away from home that was available for the conduct of such activities.

See H.R. REP. NO. 105-148, at 407-08 (1997).

<sup>144</sup> See Massey, *supra* note 115 (Future guidance from the IRS and the Treasury will be "helpful in determining whether a taxpayer [is] conducting 'substantial' administrative or management activities away from the home office."). There is also uncertainty regarding what will constitute "administrative and management activities" for purposes of § 280A(c)(1). Neither the Tax Code nor regulations define "administrative or management activities."

<sup>145</sup> Although the word "substantial" is ordinarily defined as "considerable in quantity; significantly large," WEBSTER'S NINTH NEW COLLEGIATE DICTIONARY 1176 (1985), the word "substantial" is not defined in I.R.C. § 280A(c)(1) or the regulations.

To resolve the uncertainty surrounding the word "substantial," a test will most likely be developed to determine what constitutes "substantial administrative or management activities." In determining what would be considered "substantial administrative or management activities," lawmakers may very well adopt the same test used by the Supreme Court in *Soliman* to determine "whether a home office is the principal place of business." Commissioner v. Soliman, 506 U.S. 168, 174 (1993). In developing the proper test for determining whether a home office is the "principal place of business," the Court in *Soliman* stated:

[W]e cannot develop an objective formula that yields a clear answer in every case. The inquiry is more subtle, with the ultimate determination of the principal place of business being dependent upon the particular facts of each case. There are, however, two primary considerations in deciding whether a home office is a taxpayer's principal place of business: the relative importance of the activities performed at each business location and the time spent at each place.

*Id.* at 174-75.

The *Soliman* test appears to be very analogous to the test needed to determine whether administrative or management activities performed outside the home are "substantial." The first prong, comparing the relative importance of the activities, would evaluate how "significant" the administrative or management work performed at the home is compared to the administrative or management work performed outside the home. Arguably, different types of administrative or management activities are "more significant" than others. Management functions, such as client contact or scheduling work for subordinates, could be viewed as more important than some administrative functions, such as paperwork, billing, or reading trade journals. A comparative analysis would determine where the more important administrative or management functions are performed. The second prong, comparing the time spent at each location, would evaluate how "considerable" the administrative or management work performed at the home is compared to the administrative or management work performed outside the home.

An alternative approach would be to only consider the time spent at each business location. This approach assumes that all administrative or management activities are equally important as compared to each other, and, therefore, a "relative importance" prong is not

word “substantial” is interpreted to mean that only minimal activities can be performed outside the home, then it is likely that the home office deduction will be denied in most cases. Support for such an interpretation is found in the committee report to TRA.<sup>146</sup> The committee report defines “not substantial” as when “the taxpayer occasionally does minimal paperwork at another fixed location of the business.”<sup>147</sup> Does this mean that “substantial” work is defined as anything beyond occasional, minimal paperwork? If so, then performance of occasional minimal paperwork plus phone calls, for example, would be considered substantial, and the home office deduction would be denied.<sup>148</sup>

However, if “substantial” is interpreted to mean that considerable activities must be performed outside the home before the home office deduction is denied, then the home office deduction will be available to many taxpayers. Such an interpretation is supported by the argument made in *Soliman*, that the “ordinary, everyday sense” of the word “substantial” should be used.<sup>149</sup> Thus, despite language in the committee report to the contrary,<sup>150</sup> the “ordinary, everyday sense” of the word “substantial” would include much more than occasional, minimal paperwork. The ordinary meaning of the word substantial is “considerable in quantity: significantly large.”<sup>151</sup> Therefore, under an ordinary meaning interpretation, the administrative and management activities performed

---

necessary. The relative importance prong was necessary in *Soliman* because nonadministrative activities were viewed by the Court as relatively more important than administrative activities. See *Soliman*, 506 U.S. at 178. Here, the comparison only involves administrative or management functions performed by the taxpayer either: (1) at the home, or (2) at another fixed location. Comparing the time spent on administrative or management functions at home versus time spent at another fixed location would be sufficient to determine whether administrative or management functions performed outside the home office were “substantial” enough to deny the taxpayer a home office deduction.

<sup>146</sup> See H.R. REP. NO. 105-220, pt. IX, at 464 (1997).

<sup>147</sup> *Id.*

<sup>148</sup> Under the current all-or-nothing approach, the taxpayer is *completely denied* the home office deduction if “substantial administrative and management activities” are performed outside the home office. See I.R.C. § 280A(c)(1) (1998) (flush language). In contrast, under the proposed actual use test, see discussion *infra* Part IV.C.1, the taxpayer receives a home office deduction to the extent the home office is *actually used* in connection with the taxpayer’s business. The actual use test includes any necessary activities of the taxpayer performed in connection with the taxpayer’s business, including administrative and management activities. Therefore, the proposed actual use test eliminates the uncertainty of the current all-or-nothing approach.

<sup>149</sup> See *Soliman*, 506 U.S. at 174 (“In interpreting the meaning of the words in a revenue act, we look to the ‘ordinary, everyday senses’ of the words.”) (quoting *Crane v. Commissioner*, 331 U.S. 1, 6 (1947)).

<sup>150</sup> See *supra* note 146 and accompanying text.

<sup>151</sup> WEBSTER’S NINTH NEW COLLEGIATE DICTIONARY, *supra* note 145, at 1176.

away from the home would have to be "considerable" and "significant" before the home office deduction would be disallowed. However, until the word "substantial" is defined, the extent of the allowance of the home office deduction under section 280A as amended by the TRA will be uncertain.<sup>152</sup>

#### IV. HOME OFFICE DEDUCTION IN NEED OF REPAIR

##### A. *The Current All-or-Nothing Approach to the Home Office Deduction Creates Unfairness, Inequality, and Uncertainty*

As demonstrated above, the current all-or-nothing approach to the home office deduction creates unfairness, inequality, and uncertainty.<sup>153</sup> The current approach creates a situation where a taxpayer may have *actually used* the home office for business purposes throughout the taxable year, but is *completely denied* a home office deduction.

For example, compare Doctor 1 with Doctor 2. Both doctors have a hospital-provided office and a home office. Doctor 1 manages his business one hundred percent from the home office and never uses the hospital-provided office. Doctor 2 performs administrative and management activities both from her home office and from the hospital-provided office. Assume that Doctor 2 performs substantial administrative and management activities from the hospital-provided office. Because Doctor 1 manages his business one hundred percent from the home office, he is entitled to a full home office deduction under amended section 280A(c)(1). Doctor 2 fails, however, to qualify for the home office deduction both under section 280A(c)(1) as amended by TRA<sup>154</sup> and under the

---

<sup>152</sup> It is important to remember that if the taxpayer fails the definition of "principal place of business" under § 280A(c)(1)(A) as amended by the TRA, the comparative analysis test of *Soliman* still applies to determine if the taxpayer meets the definition of "principal place of business." See *Post-'98 Use of a Home Office for Administrative and Management Activities of a Trade or Business*, 16 Fed. Tax. Coordinator 2d (RIA) ¶ L-1309.1, at 34,055-56. "In cases where a taxpayer's use of a home office does not satisfy the provision's two-part test, . . . the taxpayer nonetheless may be able to claim a home office deduction . . . [under the present law] 'principal place of business' [exception] or any other . . . provision of section 280A." *Id.* So, even if the uncertainty surrounding the amendment is resolved, the uncertainty of the *Soliman* decision still survives. See discussion *supra* Part II.B.3.

<sup>153</sup> See discussion *supra* Parts II.B, III.C.1.

<sup>154</sup> Amended § 280A(c)(1) allows a home office deduction if the office is "used by the taxpayer to conduct administrative or management activities of the taxpayer's trade or business, and there is no other fixed location of the trade or business where the taxpayer conducts substantial administrative or management activities of the trade or business." I.R.C. § 280A(c)(1) (1998). Because Doctor 2 performed "substantial administrative [and] management activities" from the hospital-provided office, Doctor 2 fails to meet the definition



comparative analysis test of *Soliman*.<sup>155</sup> Therefore, even though Doctor 2 did in fact use the home office, she is *completely denied* any deduction for the *actual business use* of the home office.

The example demonstrates the inequities of the current all-or-nothing approach. Both doctors *actually used* the home office in connection with the taxpayer's business, but only one received a home office deduction. The other is *completely denied* any deduction. This is unfair, treats similarly situated taxpayers differently, and leads to uncertainty.

#### B. *New Approach to Home Office Deduction: Applying Mixed-Use Allocation Theory to the Home Office Deduction*

Because the current approach to the home office deduction creates inequities, a new approach is necessary. The premise of the new approach is that, while the home is generally a personal asset,<sup>156</sup> it becomes a mixed-use asset when a business is run from the home. As a mixed-use asset, an allocation between the business and personal use is necessary. Applying mixed-use allocation theory would allow a home office deduction to the extent the taxpayer *actually uses* the home office in connection with the taxpayer's business.<sup>157</sup>

Two other areas of tax law use an actual use approach for allocating expenses between mixed business and personal use. The first is the rental of the home.<sup>158</sup> A taxpayer who both rents and personally uses a dwelling unit must allocate the expenses between the rental activity and the personal use.<sup>159</sup> A taxpayer is only entitled to a deduction for expenses attributable to the *actual* rental of the unit using the following formula: the rental expense allocation formula provides that expenses attributable to the rental of a dwelling unit are allocated to the rental activity by multiplying the expenses for a taxable year by a fraction, the numerator of which is the number of fair rental days during the taxable year, and the denominator of which is the total number of days that the

---

of "principal place of business" under amended § 280A(c)(1).

<sup>155</sup> Although Doctor 2 fails to qualify for the home office deduction under amended § 280A(c)(1), *see supra* note 154, Doctor 2 still can look to the comparative analysis test under *Soliman*. However, Doctor 2 fails under *Soliman* too. Like in *Soliman*, the most important activity performed by Doctor 2 is the actual treatment of patients. *See* Commissioner v. *Soliman*, 506 U.S. 168, 178 (1993). Because this activity takes place at the hospital, and not the home office, Doctor 2 fails to qualify for the home office deduction under the comparative analysis test of *Soliman*.

<sup>156</sup> *See* I.R.C. § 280A(a).

<sup>157</sup> *See* proposed actual use test *supra* Part IV.C.1.

<sup>158</sup> *See Hobby, Home Business and Home Rental Losses, supra* note 37.

<sup>159</sup> *See* I.R.C. § 280A(e)(1); Prop. Treas. Reg. § 1.280A-3(a), 45 Fed. Reg. 52399 (1980).

unit is used for any purpose during the same taxable year.<sup>160</sup> Therefore, the application of mixed-use allocation theory to the rental of the home ensures a rental deduction is allowed only to the extent the taxpayer *actually rents* the unit at fair rental value.

The second is the business use of the car.<sup>161</sup> If a car is used both for business and for personal purposes, an apportionment between the business and personal use must be made.<sup>162</sup> In making such allocation, the taxpayer may use: (1) a standard mileage rate method, or (2) the actual costs attributable to the business usage.<sup>163</sup> Applying mixed-use allocation theory, the taxpayer is allowed a deduction for the *actual business use* of the car.<sup>164</sup>

The application of the mixed-use allocation theory ensures a proper deduction for the actual business-related costs that a taxpayer incurs related to a mixed-use asset.<sup>165</sup> Therefore, a similar allocation between personal and business mixed use of the home office would ensure a proper deduction for the actual business-related costs the taxpayer incurs in using his or her own home to operate a business.

### *C. New Home Office Deduction Statute: "Actual Use" Test—A Proposal*

#### *1. Proposed "Actual Use" Test*

Based upon mixed-use allocation theory,<sup>166</sup> a new home office deduction statute is proposed.<sup>167</sup> The proposed "actual use" test would allow a home office

---

<sup>160</sup> See I.R.C. § 280A(e)(1); Prop. Treas. Reg. § 1.280A-3(c)(1), 45 Fed. Reg. 52399 (1980).

<sup>161</sup> See *Travel & Transportation Expenses—Deductions and Recordkeeping Requirements*, *supra* note 37.

<sup>162</sup> See *id.* at A-90.

<sup>163</sup> See *id.* at A-90 to A-91.

<sup>164</sup> See *id.* at A-89 to A-90.

<sup>165</sup> See *id.* at A-159.

<sup>166</sup> See *supra* Part IV.B.

<sup>167</sup> There are other proposals for amending the home office deduction that apply the mixed-use allocation theory. One such proposal is as follows:

Amend Section 280A(c)(1) to allow an exception to the "exclusive use" rule permitting mixed use of space for business and personal purposes in the case of taxpayers who conduct home-based businesses while caring for dependents. Dependents should be defined to include not only children but also elderly parents or a sick spouse.

deduction for the expenses attributable to the *actual use* of the home in connection with the taxpayer's business. The proposed home office deduction would amend section 280A(c)(1) to read as follows:

Section 280A(a)<sup>168</sup> shall not apply to any item to the extent such item is allocable to a portion of the dwelling unit which is *actually used* to perform any necessary activities in connection with the taxpayer's trade or business, but only for the *actual hours of such use*.

To determine the expenses attributable to the *actual use* of the home in connection with the taxpayer's business, the portion of the home used in connection with the business is multiplied by the total expenses of the home to arrive at the expenses allocable to the actual business use for the entire year. Then, the expenses for the entire year are divided by the total hours in a year to determine the expenses allocable to the business use per hour. Finally, the expenses allocable to the business use per hour are multiplied by the hours actually used in connection with the taxpayer's business to arrive at the home office deduction. This equation is illustrated in Figure 1.

---

alfe.html> (arguing that the exclusive rule of the home office deduction denies meaningful deductions to those who care for their children while maintaining a home business).

Another proposal applying the mixed-use allocation theory is as follows:

Amend Section 280A(c)(4)(C) to revise the allocation rule for mixed uses to only compare only [sic] the amount of time a room is in fact used for a business or personal purpose and not count the time a room is used for no purpose at all (e.g., nighttime). This would eliminate the reduction in the deductions for business use for the time the mixed use room is used for no purpose and put home-based taxpayers on a par with non-home-based taxpayers who do not suffer a loss in deductions for their office space when the office is closed.

*Id.* (arguing that the inequitable treatment between home office workers and those who rent places the home worker at a competitive disadvantage).

<sup>168</sup> Section 280A(a) is the general rule disallowing certain expenses in connection with the business use of the home:

(a) General rule.—Except as otherwise provided in this section, in the case of a taxpayer who is an individual or an S corporation, no deduction otherwise allowable under this chapter shall be allowed with respect to the use of a dwelling unit which is used by the taxpayer during the taxable year as a residence.

I.R.C. § 280A(a) (1998).

**Figure 1**

Portion of home used in connection with business	x	Total expenses of the home	=	Expenses allocable to the actual business use for the entire year	=	Expenses allocable to the business use per hour
				<hr/>		
				Total hours in one year		
Expenses allocable to the business use per hour	x	Hours actually used in connection with taxpayer's business	=	Amount of Home office deduction		

### a. Elements of the Proposed "Actual Use" Test

The proposed actual use test eliminates the exclusive and regular use requirements.<sup>169</sup> The elimination of the exclusive use requirement allows the

---

<sup>169</sup> By eliminating the exclusive and regular requirements, the proposed actual use test loses some of the objectivity provided by the current law. But the movement in the current law has been away from objectivity and has focused more on the reality of current small business operations. See GENERAL EXPLANATION OF TAX LEGISLATION, *supra* note 128. Compare the objectivity of the *Soliman* decision to the more subjective TRA amendment. The *Soliman* comparative analysis test is very objective. By looking to where the most important activities for that particular type of business takes place, see *Commissioner v. Soliman*, 506 U.S. 168, 174 (1993), the taxpayer's principal place of business could be objectively determined. TRA, on the other hand, allows a home office deduction to any taxpayer who manages his business from the home. See I.R.C. § 280A(c)(1) (flush language). This involves a subjective determination by the taxpayer of where the administrative and management activities of the business take place.

The TRA amendment is actually more subjective than many of the proposals leading up to the amendment were. For example, before the TRA amendment was passed, Ann Margaret Bittinger proposed that an *essential* requirement be added to the home office deduction. See Bittinger, *supra* note 2, at 948. Her proposal added an element of objectivity by requiring that only essential activities performed in the home office would be deductible. See *id.* Under her proposal, only if the work must have been performed in the home office due to the lack of an alternative location should the taxpayer be entitled to the deduction. See *id.* A home office should not be deductible where the use of the home was "purely a matter of personal convenience, comfort, or economy." *Id.* at 949. The objectionable part of her proposal is that if the taxpayer has another location from which to perform essential activities of the business, the taxpayer would not be entitled to the home office deduction.

However, under the TRA amendment, the taxpayer is entitled to a home office deduction even if the taxpayer opts not to use an office away from the home that was available for the use. See discussion *supra* Part III.C.1.a. Under TRA the taxpayer could have a home office and a rented office and still be entitled to a home office deduction. The amendment, therefore, is less subjective than the Bittinger proposal.

Likewise, the proposed actual use test relies on the subjective determination by the taxpayer of where business activities take place. The flexibility of the proposal creates even more subjectivity. The flexibility allows the taxpayer to move the business operations throughout the home. The substantiation and recordkeeping requirements will provide a level of objectivity because the taxpayer knows that, upon IRS audit, the taxpayer will be required to substantiate the home office deduction.

The subjectivity of the home office deduction has been most troubling for lawmakers. Any test that looks to where the taxpayer spends his or her time is very difficult to substantiate. It is essentially a matter of the taxpayer's word as to his or her whereabouts. That is why the proposed actual use test would be accompanied by very stringent substantiation requirements. See discussion *infra* Part IV.C.1.d. The requirement that activities performed in the home office be *necessary* also adds objectivity to the proposed actual use test. See Part IV.C.1. It is also important to note that compliance with the U.S. income tax system is voluntary. The voluntary nature of the system should not prevent taxpayers from being able to claim valid business

taxpayer to freely move the business operations throughout the home. However, the taxpayer must keep track of where business activities are conducted and the actual amount of hours spent conducting such activities. Of course, the use of exclusive office space will make the computation of the home office deduction easier, but it is not required under the proposed actual use test.

The elimination of the exclusive use requirement also entitles the taxpayer to a deduction for the use of certain items in the house that before would not have entitled the taxpayer to a business deduction. For example, with an exclusive use requirement, a taxpayer cannot deduct the costs associated with using the taxpayer's kitchen to prepare food for his or her business. Because the taxpayer also uses the kitchen for personal purposes, the taxpayer fails the exclusive use requirement.<sup>170</sup> But, without the exclusive use requirement, as under the proposed actual use test, the taxpayer could deduct the costs associated with the *actual use* of the kitchen to prepare food for the business. The deduction is allowed for the actual hours the kitchen is used to prepare the food.

The proposed actual use test replaces the exclusive and regular use requirements with the requirement that the taxpayer *actually uses* the home to perform any necessary<sup>171</sup> activities in connection with the taxpayer's trade or business. The proposed actual use test does not distinguish between employees and self-employed individuals.<sup>172</sup> The *necessary* standard will ensure that employees, like the self-employed, will only be able to deduct expenses attributable to necessary activities performed in the home office.<sup>173</sup>

#### b. *Application of Proposed "Actual Use" Test*

The application of the proposed actual use test will ensure a proper

---

deductions that can be substantiated.

<sup>170</sup> See *Baie v. Commissioner*, 74 T.C. 105, 109 (1980) (holding that the taxpayer's hotdog stand was the "principal place of business" and not the taxpayer's kitchen, which was used both for business and personal purposes).

<sup>171</sup> See Fortin, *supra* note 106, at 968-69 (proposing that the home office deduction simply requires that the home office be necessary for business purposes, regardless of the circumstances).

<sup>172</sup> Under the proposed actual use test, the "convenience of the employer" language is eliminated. This is no longer needed because, as argued above at Part III.C.2, the employee should enjoy the convenience of the home office just as the self-employed does. Also, the certainty of the deduction does not leave much room for abuse by any taxpayer, including employees.

It is illogical and unfair to distinguish between employees and the self-employed for home office deduction purposes. See *id.* at 969. To the extent that it is more difficult for an employee to prove that his home office is necessary, he is less likely to be granted a deduction. See *id.*

<sup>173</sup> See *id.*

deduction for the actual business-related costs the taxpayer incurs in using his or her own home to operate a business. To illustrate the proposed actual use test, reconsider Doctor 2 of the example in Part IV.A above. Assume the following about Doctor 2: the percentage of the home used exclusively as the home office is 10%; the total expenses of the home are \$20,000; and Doctor 2 *actually works* 3,600 hours (150 days) in her home office. Instead of being *completely denied* a home office deduction under the current all-or-nothing approach, the actual use test would allow Doctor 2 a \$822<sup>174</sup> home office deduction.

### c. Simplicity of the Proposed "Actual Use" Test

The above illustration of the mechanics of the proposed actual use test reveals its simplicity. The taxpayer only needs to determine: (1) the portion of the home *actually used* in connection with the business,<sup>175</sup> (2) the total costs of the home,<sup>176</sup> and (3) *actual hours used* in connection with the business. Simplicity is especially important in the home office deduction area. Many small business owners who operate businesses from their homes lack the finances and sophistication to refer frequently to accountants or lawyers for tax planning or advice.<sup>177</sup> The home office deduction must be easy for the unsophisticated, small business owner to understand.<sup>178</sup>

Some of the simplicity is lost, however, with the flexibility the proposal allows. Because the proposal eliminates the exclusive use requirement, the

---

<sup>174</sup> Applying the actual use test formula, the home office deduction for Doctor 2 is computed as follows:  $10\% \times \$20,000 = \$2,000 / 8,760 \text{ hours} = 0.2283 \times 3,600 \text{ hours} = \$822$  home office deduction.

An interesting point is made by William Kelliher, a partner with KPMG Peat Marwick's National Tax Office, Washington. Kelliher notes that "he is always surprised at how much attention the [home office deduction] received, in light of the actual tax savings." Massey, *supra* note 115. The home office deduction "usually do[es] not amount to much: 'the pot at the end of the rainbow is small' . . . . You'd think there would be a large number of dollars at stake." *Id.*; see also Harvath, *supra* note 11, at 200 n.160 ("The amount of the [home office] deduction is often minimal to begin with, since it represents only that portion of the residence used for the business.").

<sup>175</sup> Under proposed regulations to § 280A, the portion of the home used in connection with the business is determined by comparing the square feet of the office with the square feet of the entire home. See Prop. Treas. Reg. § 1.280A-2(i)(3), 45 Fed. Reg. 52404 (1980). "Expenses which are attributable only to certain portions of the unit, e.g., repairs to kitchen fixtures, shall be allocated in full to those portions of the unit." *Id.*

<sup>176</sup> See Prop. Treas. Reg. § 1.280A-1(a), 45 Fed. Reg. 52401 (1980).

<sup>177</sup> See Bittinger, *supra* note 2, at 946, 948.

<sup>178</sup> See *id.*

taxpayer is free to move the business operations throughout the home.<sup>179</sup> The mobility of the business within the home is especially important to home workers with children. The ability to move the business operations to wherever is convenient in the house fulfills the work-at-home mother's need to be physically proximate with the children.<sup>180</sup> With such mobility comes the added complexity of keeping track of where business activities are conducted throughout the home. However, the flexibility is worth a little complexity.

#### d. *Substantiation Requirements*

Administrative efficiency is an important consideration for any new tax proposal.<sup>181</sup> The proposed actual use test places no more of a burden on either the government or the taxpayer to comply with its requirements than do other areas of tax law. For example, section 274(d) provides that a taxpayer must substantiate by adequate records or by sufficient evidence the amount, time, place and business purpose of an expenditure before the taxpayer is entitled to a deduction listed therein.<sup>182</sup> The same substantiation, reporting, and recordkeeping requirements would apply to the home office deduction. Under the proposed actual use test, the taxpayer who claims a home office deduction must be able to substantiate the *actual hours* the taxpayer used the home in connection with the business. The records will indicate what activity was performed, when the activity was performed, and the amount of time spent.

---

<sup>179</sup> See discussion *supra* Part IV.C.1.a.

<sup>180</sup> See Carlie Sorensen Dixon, *Family Research Council: Making the Home Office Tax Deduction More Available to Parents* (visited Mar. 13, 1998) <<http://www.frc.org/frc/perspective/pv95a1fe.html>>. The exclusive use requirement causes many home workers who also care for children to be denied the home office deduction. Because exclusive use requires that the office space be used for no other purpose, home workers cannot watch their children from the office. See *id.*

<sup>181</sup> See WEST'S FEDERAL TAXATION, *supra* note 39, at 1-4. The canons of taxation include *convenience and economy*. See *id.* *Convenience* calls for tax law that is administratively simple. See *id.* "If a tax is easily assessed and collected and its administrative costs are low, it should be favored." *Id.* *Economy* calls for tax law that "involves only nominal collection costs by the government and minimal compliance costs on the part of the taxpayer." *Id.*

There are also budgetary concerns. Under the proposed actual use test, more taxpayers will be allowed a home office deduction. However, because the test only allows a deduction for the amount of *actual hours of use*, the amount of the deduction will be lower.

<sup>182</sup> See I.R.C. § 274(d) (1998).



## V. CONCLUSION

The proposed actual use test creates a home office deduction that is fair, equitable, and certain. To illustrate the fairness, equality, and certainty of the proposed actual use test, reconsider the Doctor 1/Doctor 2 example of Part IV.A above. Under the proposed actual use test, instead of *completely denying* Doctor 2 the home office deduction, Doctor 2 will receive a deduction for the *actual use* of the home office in connection with the taxpayer's business. Likewise, Doctor 1 will receive a home office deduction, but only to the extent Doctor 1 *actually uses* the home office in connection with the taxpayer's business. This is fair because both doctors receive a deduction to the extent they *actually used* the home office. The proposed actual use test also treats similarly situated taxpayers equally. Although the amount of the deduction will vary based on the *actual hours the home office is used*, both taxpayers have an equal opportunity to receive the home office deduction. The proposed test also adds certainty to the deduction. The taxpayer can be certain that he or she will receive a home office deduction to the extent the taxpayer *actually uses* the home office in connection with the taxpayer's business.<sup>183</sup>

Therefore, the proposed actual use test is fair, equitable, certain, simple, realistic, and allows all taxpayers the opportunity to conveniently work from the home.

---

<sup>183</sup> See *supra* Part II.B.3 (regarding the importance of the taxpayer being able to plan throughout the taxable year for the home office deduction).

